SOUTH-WESTERN
CENGAGE Learning

Personal Financial Literacy 2e

Joan S. Ryan

Personal Financial Literacy 2e

Joan S. Ryan

Clackamas Community College

Oregon City, Oregon

SOUTH-WESTERN CENGAGE Learning

Australia • Brazil • Japan • Korea • Mexico • Singapore • Spain • United Kingdom • United States

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

This is an electronic version of the print textbook. Due to electronic rights restrictions, some third party content may be suppressed. Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. The publisher reserves the right to remove content from this title at any time if subsequent rights restrictions require it. For valuable information on pricing, previous editions, changes to current editions, and alternate formats, please visit www.cengage.com/highered to search by ISBN#, author, title, or keyword for materials in your areas of interest.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

SOUTH-WESTERN
CENGAGE Learning™

Personal Financial Literacy
Second Edition
Joan S. Ryan

Vice President of Editorial, Business: Jack W. Calhoun

Vice President/Editor-in-Chief: Karen Schmohe

Executive Editor: Eve Lewis

Senior Developmental Editor: Dr. Inell Bolls

Consulting Editor: Peggy Shelton

Marketing Manager: Alla Reese

Associate Content Project Manager: Jana Lewis

Senior Media Editor: Mike Jackson

Senior Manufacturing Coordinator: Kevin Kluck

Production Service: MPS Limited, a Macmillan Company

Senior Art Director: Tippy McIntosh

Internal Designer: Lou Ann Thesing

Cover Designer: Lou Ann Thesing

Cover Images:

©istock Images: © Joshua Hodge Photography, ©Dan Wilton, ©Catherine Lane, ©Andresr, ©Diego Cervo

Rights Acquisition Specialist, Image: John Hill

Rights Acquisition Specialist, Text: Mardell Glinski-Schultz

Photo Researcher: Darren Wright

© 2012, 2008 South-Western, Cengage Learning

ALL RIGHTS RESERVED. No part of this work covered by the copyright herein may be reproduced, transmitted, stored or used in any form or by any means graphic, electronic, or mechanical, including but not limited to photocopying, recording, scanning, digitizing, taping, Web distribution, information networks, or information storage and retrieval systems, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without the prior written permission of the publisher.

For product information and technology assistance, contact us at
Cengage Learning Customer & Sales Support, 1-800-354-9706

For permission to use material from this text or product, submit all requests online at **www.cengage.com/permissions**
Further permissions questions can be emailed to **permissionrequest@cengage.com**

Exam*View*® is a registered trademark of eInstruction Corp. Windows is a registered trademark of the Microsoft Corporation used herein under license. Macintosh and Power Macintosh are registered trademarks of Apple Computer, Inc. used herein under license.

**These Career Cluster icons are being used with permission of the: States' Career Clusters Initiative, 2009, www.careerclusters.org

Library of Congress Control Number: 2010936911

Student Edition:
ISBN-13: 978-0-8400-5829-4
ISBN-10: 0-8400-5829-2

South-Western
5191 Natorp Boulevard
Mason, OH 45040
USA

Cengage Learning products are represented in Canada by Nelson Education, Ltd.

For your course and learning solutions, visit **www.cengage.com/school** Visit our company website at **www.cengage.com**

Printed in the United States of America
1 2 3 4 5 6 7 14 13 12 11 10

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Contents

Chapter 1
How Your Choices Affect Income 1

1-1 Personal Skills and the Job Market 2
1-2 The Economy and Your Education 11
1-3 Job Application Skills and Tools 21
Exploring Careers in Journalism 34
Chapter 1 Assessment 35

Chapter 2
Income, Benefits, and Taxes 38

2-1 Earned Income and Benefits 39
2-2 Unearned Income and Payments 51
2-3 Taxes and Other Deductions 61
Exploring Careers in Tax Collection 72
Chapter 2 Assessment 73

Chapter 3
Your Purchasing Power 76

3-1 Inflation and the Value of Money 77
3-2 Prices and Consumer Choices 86
3-3 Getting More for Your Money 93
3-4 Consumer Rights and Responsibilities 101
Exploring Careers in Education 113
Chapter 3 Assessment 114

Chapter 4
Financial Decisions and Planning 117

4-1 Resources and Choices 118
4-2 Basics of Budgeting 125
4-3 Personal Financial Planning 134
Exploring Careers in Manufacturing 143
Chapter 4 Assessment 144

Chapter 5
The Banking System 148

5-1 Checking Accounts 149
5-2 Saving Accounts 162
5-3 Banking Services and Fees 172
Exploring Careers in Banking 181
Chapter 5 Assessment 182

Chapter 6
Personal Risk Management 185

6-1 Risk Assessment and Strategies 186
6-2 Protecting Income 194
6-3 Protecting Property 205
Exploring Careers in Insurance 215
Chapter 6 Assessment 216

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 7

Buying Decisions 219

7-1 Designing a Buying Plan 220
7-2 Getting Started with Credit 228
7-3 Computing the Costs of Credit 236
Exploring Careers in Credit 245
Chapter 7 Assessment 246

Chapter 8

Preserving Your Credit 249

8-1 Identifying Financial Issues 250
8-2 Long-Term Debt Repayment 258
8-3 Credit Management 267
Exploring Careers in Law Enforcement 275
Chapter 8 Assessment 276

Chapter 9

Credit Problems and Laws 279

9-1 Resolving Credit Problems 280
9-2 Bankruptcy Choices 290
9-3 Consumer Protection Laws 298
Exploring Careers in Architecture 308
Chapter 9 Assessment 309

Chapter 10

Basics of Saving and Investing 312

10-1 Reasons for Saving and Investing 313
10-2 Principles of Saving and Investing 323
10-3 Strategies for Saving and Investing 331
Exploring Careers in Marketing 339
Chapter 10 Assessment 340

Chapter 11

Saving and Investing Options 343

11-1 Low-Risk Choices 344
11-2 Medium-Risk Choices 354
11-3 High-Risk Choices 363
Exploring Careers in Computer Technology 372
Chapter 11 Assessment 373

Chapter 12

Buying and Selling Investments 376

12-1 Researching Investments and Markets 377
12-2 Buying and Selling Securities 389
12-3 Regulatory Agencies and Laws 397
Exploring Careers in Agriculture 406
Chapter 12 Assessment 407

Glossary 410

Glosario 419

Index 429

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Reviewers

Johanna Bodenhamer
Business Teacher
Saluda High School
Saluda, South Carolina

Dwionne R. Cannon
Business Teacher
North Atlanta High School
Atlanta, Georgia

Terry Casparro
Career Tech Facilitator
Westerville City Schools
Westerville, Ohio

Debbie Castles
Business Teacher
Stratford High School
Goose Creek, South Carolina

Brian Chalk
Business Teacher
Cooper City High School
Cooper City, Florida

Glenda Eichman
Business and Technology Teacher
Manhattan High School
Wamego, Kansas

Tammy Fehringer
Business Teacher
Peetz School
Peetz, Colorado

Jan Goddard
Business and Computer Science Teacher
Norcross High School
Norcross, Georgia

Linda Mapes
Business Teacher
Westerville South High School
Westerville, Ohio

Alice Matthews
Business Teacher
Charlestown High School
Jeffersonville, Indiana

Margarita McClain
Business Teacher
Elkhart Central High School
Elkhart, Indiana

Stephanie McCall
Career and Technical Education Department Chair
Business Teacher
Northview High School
Johns Creek, Georgia

Carol Miller
Business and Computer Science Department Chairperson
Hatboro-Horsham Sr. High School
Horsham, Pennsylvania

Lisa E. Norrington
Patapsco High School
Business Department Chair
Baltimore, Maryland

Diana Pine
Business and Technology Teacher
Jurupa Valley High School
Mira Loma, California

Kenneth Reed
Business Teacher
Blackman High School
Murfreesboro, Tennessee

Julie Rosa
Business and Technology Teacher
Jurupa Valley High School
Mira Loma, California

Judith P. Sams
Business and Information Technology
Program Specialist
Virginia Department of Education
Richmond, Virginia

About the Author

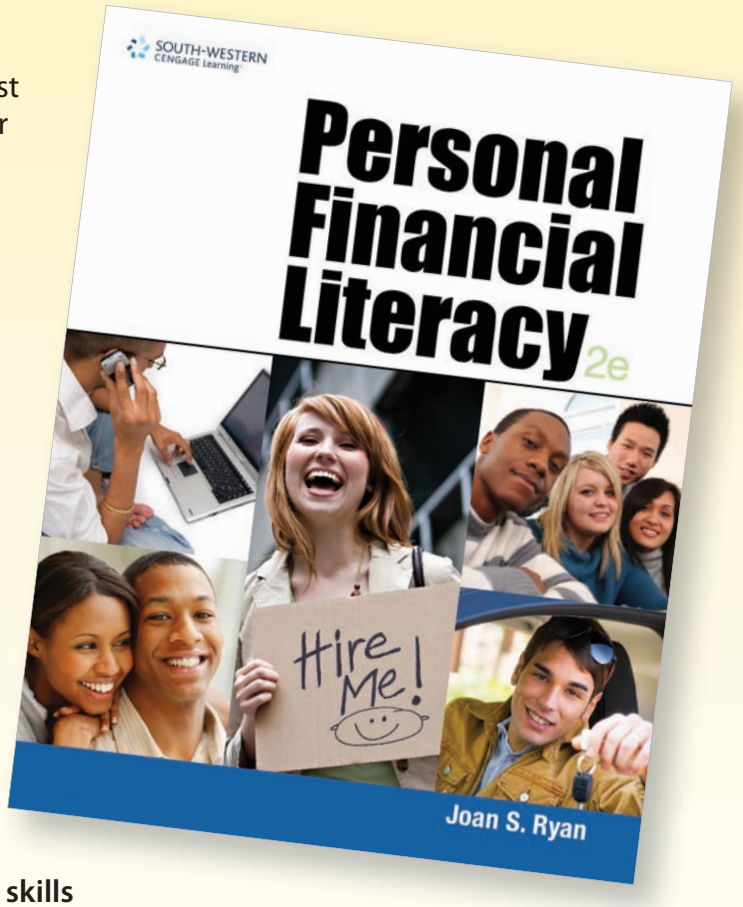
Joan Ryan, Ph.D.

Joan Ryan has taught personal finance for more than 20 years. While teaching at Willamette High School in Eugene, Oregon, she developed the original personal finance course materials for publication. Dr. Ryan currently is a faculty member in the business department at Clackamas Community College, Portland, Oregon. She also teaches accounting at Portland State University and is a Certified Managerial Accountant.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Develop Good Financial Habits for Life!

Life is filled with choices. Those who have the best and most complete information have the power to enhance their own lives and to positively affect the world around them.



Personal Financial Literacy, 2e is designed to help students learn and apply valuable life skills in **money management, career planning, saving and investing, credit management,** and **retirement planning**. By exploring successful strategies to grow and protect wealth, students will discover the richness of information available to manage their lives and their resources.

This financial life skills textbook contains twelve chapters, each divided into three or four lessons that systematically cover financial literacy standards as developed by the Jump$tart Coalition, National Business Education Association, and other state and national organizations.

Feature boxes in each chapter cover **communication skills** (listening, reading, writing, and speaking) and **success skills** (such as dealing with stress and time management). Students will read short, concise articles focused on the **economic realities and trends** of today's marketplace; they will explore potential **career choices** (linked to the 16 Career Clusters); and they will view the latest online information tags that relate the academic content to their world and take a peek at what they can expect in the future.

Each lesson contains end-of-lesson activities that review **key terms**, check **basic concepts,** and encourage **critical thinking**. With end-of-chapter assessments, students will make **academic connections** in areas such as math, communications, research, social studies, economics, ethics, and law. Each chapter ends with **"Take Action,"** an **ongoing project or application** to help students explore a major or related topic or activity.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NEW! Concepts covered in this edition include

- job search skills and online job applications
- interviewing techniques
- preparing resumes and cover letters
- the benefits and challenges of entrepreneurship
- consumer rights and responsibilities in the marketplace
- charitable giving and philanthropy
- health care providers, services, and fraud
- simple and compound interest

©Edward Bock, iStock

Financial success begins with good **career planning, goal setting,** and an understanding of **income sources and taxes**. Students will explore methods of getting more for their money and the basics of good **financial planning**, using the **banking system**, and getting started with **saving and investing**.

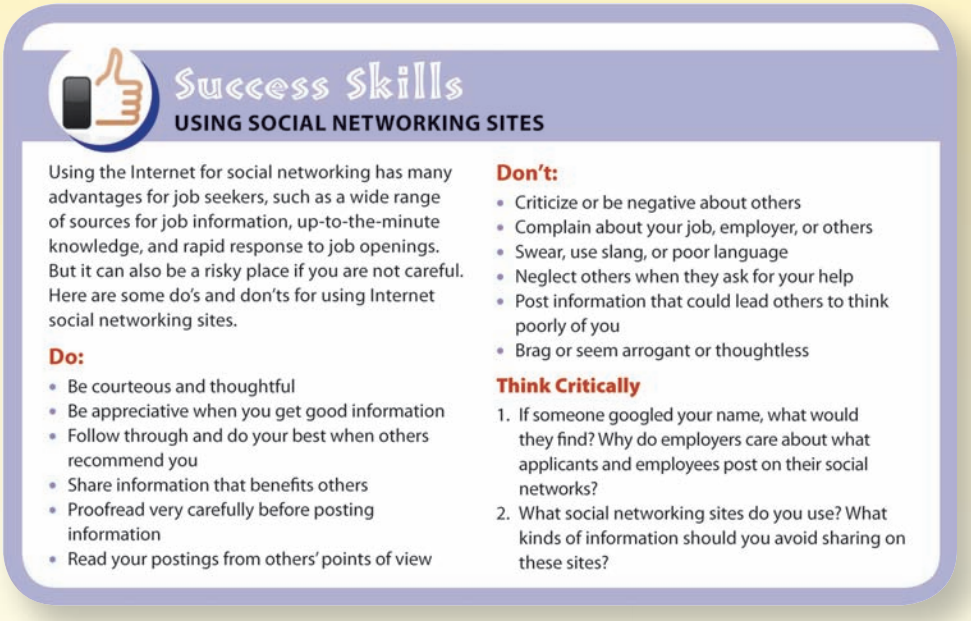
As income is earned and wealth is accumulated, students learn how to **assess risk** and protect assets, how to **use credit wisely** and minimize its costs, and how **to resolve credit problems. Saving and investing principles** lead students to effective buying and selling strategies and an understanding of financial markets, regulatory agencies, and laws that affect consumers and businesses. Incorporated into good decision making are basic economic concepts such as **inflation, monetary and fiscal policy, the business cycle,** and **pricing strategies.**

This entire package of textbook, website, student workbook, chapter tests, and instructor's resource CD, provides a resource bank designed to reach students where they are and encourage them to move boldly into the future, armed with financial literacy skills, information, and knowledge to help them make good financial decisions for a lifetime!

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Features for Student Success!

Success Skills feature provides information to help students be successful in school, work, and personal activities.



Success Skills
USING SOCIAL NETWORKING SITES

Using the Internet for social networking has many advantages for job seekers, such as a wide range of sources for job information, up-to-the-minute knowledge, and rapid response to job openings. But it can also be a risky place if you are not careful. Here are some do's and don'ts for using Internet social networking sites.

Do:

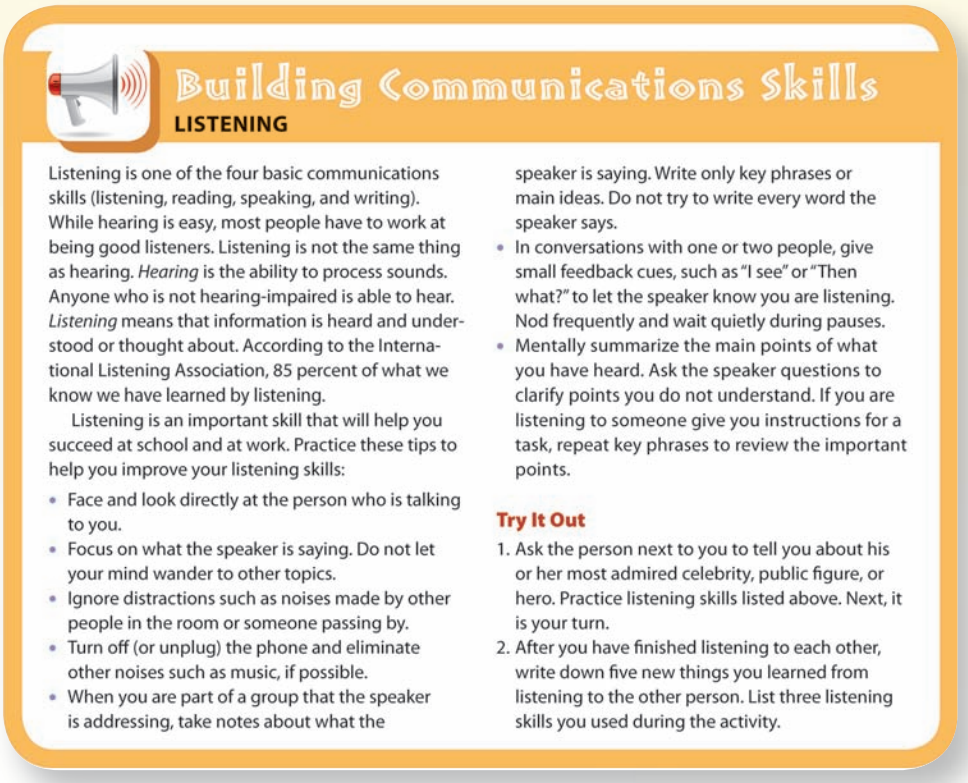
- Be courteous and thoughtful
- Be appreciative when you get good information
- Follow through and do your best when others recommend you
- Share information that benefits others
- Proofread very carefully before posting information
- Read your postings from others' points of view

Don't:

- Criticize or be negative about others
- Complain about your job, employer, or others
- Swear, use slang, or poor language
- Neglect others when they ask for your help
- Post information that could lead others to think poorly of you
- Brag or seem arrogant or thoughtless

Think Critically

1. If someone googled your name, what would they find? Why do employers care about what applicants and employees post on their social networks?
2. What social networking sites do you use? What kinds of information should you avoid sharing on these sites?



Building Communications Skills
LISTENING

Listening is one of the four basic communications skills (listening, reading, speaking, and writing). While hearing is easy, most people have to work at being good listeners. Listening is not the same thing as hearing. *Hearing* is the ability to process sounds. Anyone who is not hearing-impaired is able to hear. *Listening* means that information is heard and understood or thought about. According to the International Listening Association, 85 percent of what we know we have learned by listening.

Listening is an important skill that will help you succeed at school and at work. Practice these tips to help you improve your listening skills:

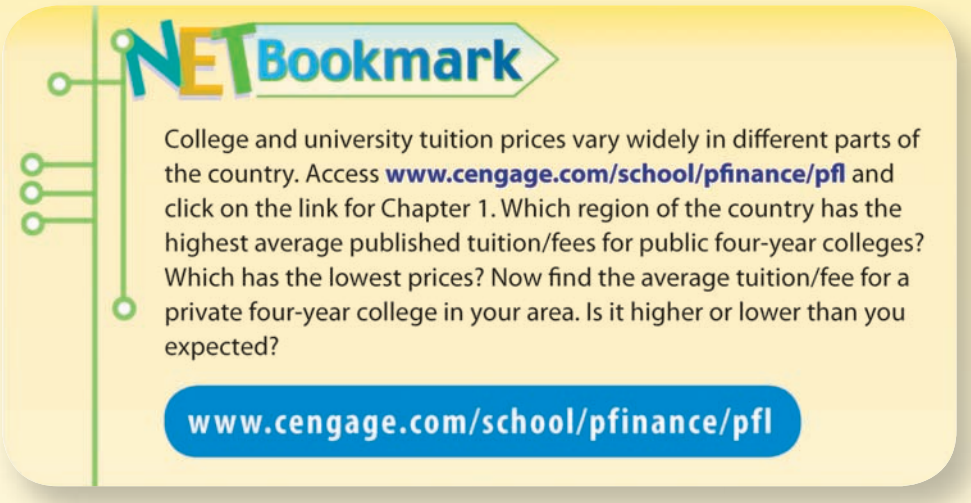
- Face and look directly at the person who is talking to you.
- Focus on what the speaker is saying. Do not let your mind wander to other topics.
- Ignore distractions such as noises made by other people in the room or someone passing by.
- Turn off (or unplug) the phone and eliminate other noises such as music, if possible.
- When you are part of a group that the speaker is addressing, take notes about what the speaker is saying. Write only key phrases or main ideas. Do not try to write every word the speaker says.
- In conversations with one or two people, give small feedback cues, such as "I see" or "Then what?" to let the speaker know you are listening. Nod frequently and wait quietly during pauses.
- Mentally summarize the main points of what you have heard. Ask the speaker questions to clarify points you do not understand. If you are listening to someone give you instructions for a task, repeat key phrases to review the important points.

Try It Out

1. Ask the person next to you to tell you about his or her most admired celebrity, public figure, or hero. Practice listening skills listed above. Next, it is your turn.
2. After you have finished listening to each other, write down five new things you learned from listening to the other person. List three listening skills you used during the activity.

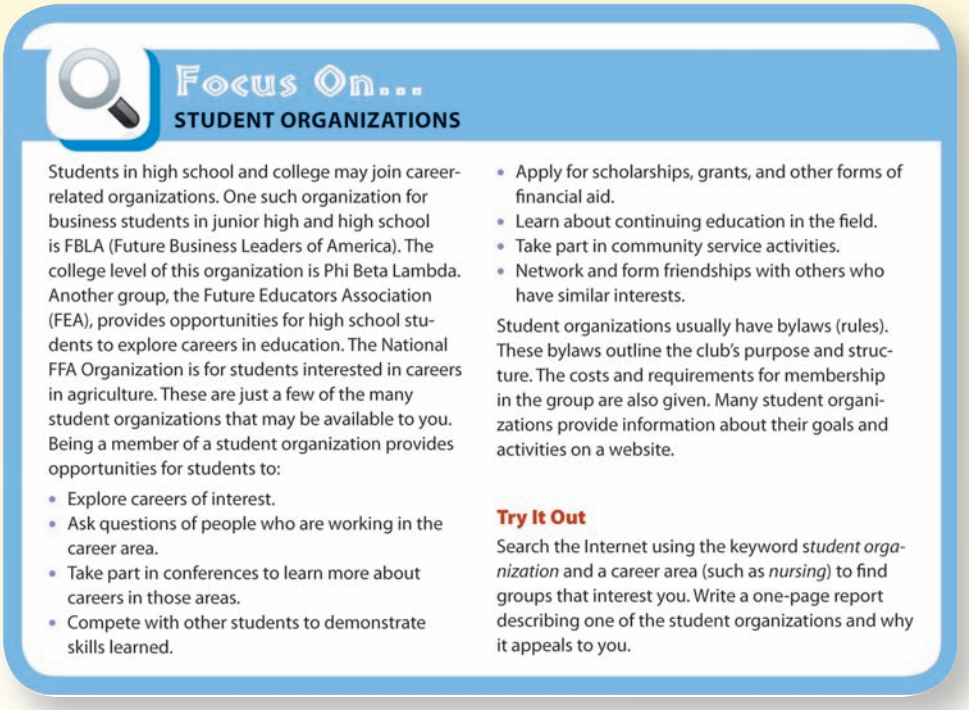
Building Communications Skills feature focuses on crucial soft skills, such as listening, reading, speaking, and writing, necessary in today's competitive workplace.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



NEW! Net Bookmark feature provides opportunities for students to use the most current, relevant information through online research.

Focus On…feature highlights specific topics related to chapter content and supports students' participation in student organizations.



Focus On...
STUDENT ORGANIZATIONS

Students in high school and college may join career-related organizations. One such organization for business students in junior high and high school is FBLA (Future Business Leaders of America). The college level of this organization is Phi Beta Lambda. Another group, the Future Educators Association (FEA), provides opportunities for high school students to explore careers in education. The National FFA Organization is for students interested in careers in agriculture. These are just a few of the many student organizations that may be available to you. Being a member of a student organization provides opportunities for students to:

- Explore careers of interest.
- Ask questions of people who are working in the career area.
- Take part in conferences to learn more about careers in those areas.
- Compete with other students to demonstrate skills learned.
- Apply for scholarships, grants, and other forms of financial aid.
- Learn about continuing education in the field.
- Take part in community service activities.
- Network and form friendships with others who have similar interests.

Student organizations usually have bylaws (rules). These bylaws outline the club's purpose and structure. The costs and requirements for membership in the group are also given. Many student organizations provide information about their goals and activities on a website.

Try It Out

Search the Internet using the keyword *student organization* and a career area (such as *nursing*) to find groups that interest you. Write a one-page report describing one of the student organizations and why it appeals to you.

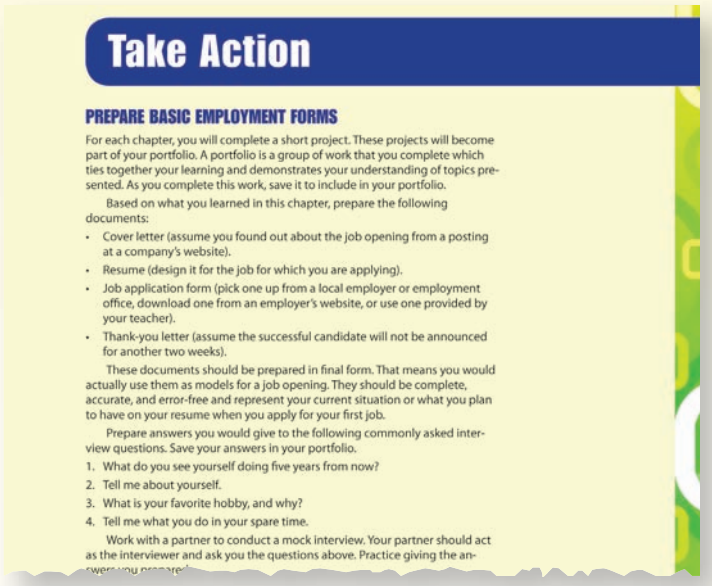
Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NEW! Exploring Careers in…feature presents specific information about careers in the areas identified by the U.S. Department of Education as the 16 Career Clusters.

CHECKPOINT

How are hard skills different from soft skills?

NEW! Checkpoint feature provides a question or activity for application of chapter topics.



NEW! Take Action feature provides students with the opportunity to synthesize the concepts by participating in an ongoing project throughout the text.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Games
Chapter 1 Supplemental Activity
Web Links

Companion Website contains more information and activities related to the textbook, including data files, games, links to relevant websites, and more!

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Assessment is Key!

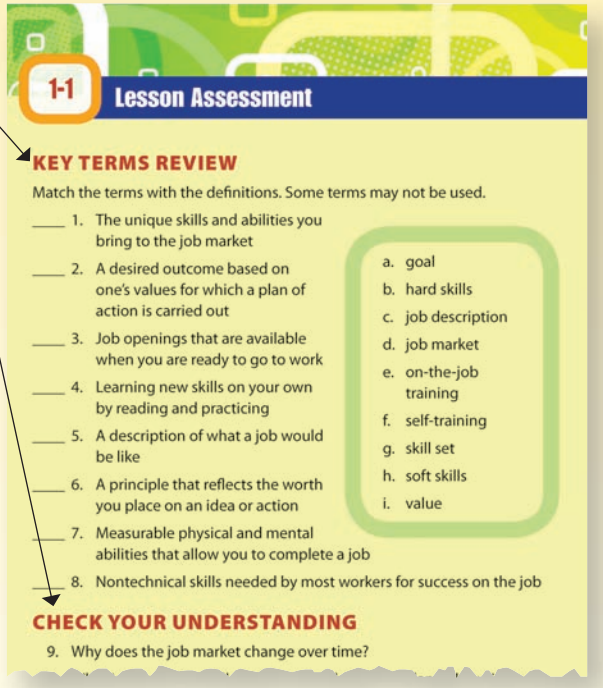
End-of-Lesson Assessment

Key Terms Review helps students understand and apply key lesson terms.

Check Your Understanding ensures students' comprehension of lesson concepts.

Think Critically encourages students to use critical thinking skills to evaluate and apply what they've learned.

Extend Your Learning provides students with additional questions and activities to extend their understanding of concepts.



1-1 Lesson Assessment

KEY TERMS REVIEW

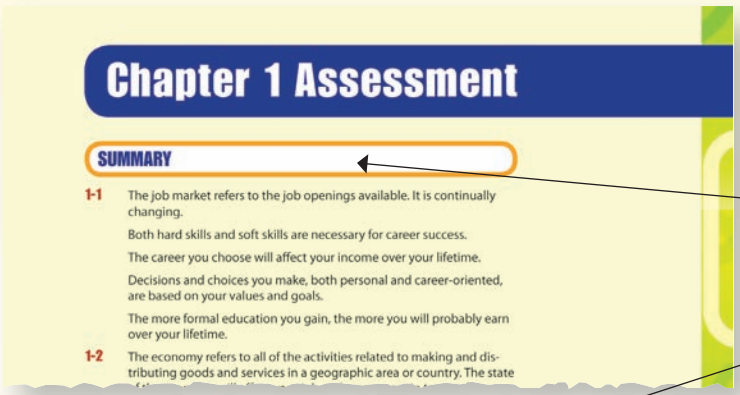
Match the terms with the definitions. Some terms may not be used.

___ 1. The unique skills and abilities you bring to the job market
___ 2. A desired outcome based on one's values for which a plan of action is carried out
___ 3. Job openings that are available when you are ready to go to work
___ 4. Learning new skills on your own by reading and practicing
___ 5. A description of what a job would be like
___ 6. A principle that reflects the worth you place on an idea or action
___ 7. Measurable physical and mental abilities that allow you to complete a job
___ 8. Nontechnical skills needed by most workers for success on the job

a. goal
b. hard skills
c. job description
d. job market
e. on-the-job training
f. self-training
g. skill set
h. soft skills
i. value

CHECK YOUR UNDERSTANDING

9. Why does the job market change over time?



Chapter 1 Assessment

SUMMARY

1-1 The job market refers to the job openings available. It is continually changing.

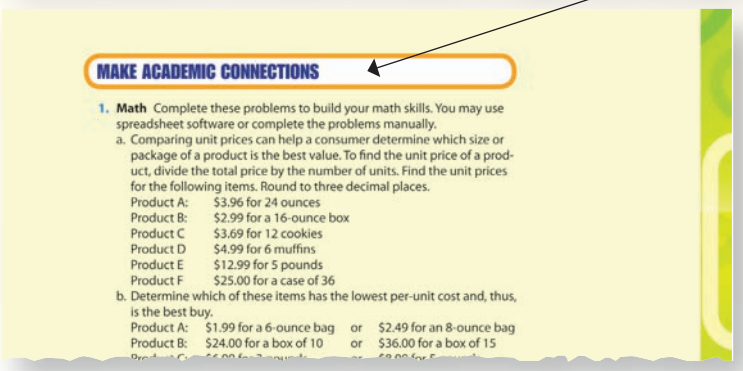
Both hard skills and soft skills are necessary for career success.

The career you choose will affect your income over your lifetime.

Decisions and choices you make, both personal and career-oriented, are based on your values and goals.

The more formal education you gain, the more you will probably earn over your lifetime.

1-2 The economy refers to all of the activities related to making and distributing goods and services in a geographic area or country. The state



MAKE ACADEMIC CONNECTIONS

1. **Math** Complete these problems to build your math skills. You may use spreadsheet software or complete the problems manually.
   a. Comparing unit prices can help a consumer determine which size or package of a product is the best value. To find the unit price of a product, divide the total price by the number of units. Find the unit prices for the following items. Round to three decimal places.
      Product A: $3.96 for 24 ounces
      Product B: $2.99 for a 16-ounce box
      Product C $3.69 for 12 cookies
      Product D $4.99 for 6 muffins
      Product E $12.99 for 5 pounds
      Product F $25.00 for a case of 36
   b. Determine which of these items has the lowest per-unit cost and, thus, is the best buy.
      Product A: $1.99 for a 6-ounce bag or $2.49 for an 8-ounce bag
      Product B: $24.00 for a box of 10 or $36.00 for a box of 15

End-of-Chapter Assessment

Summary provides a concise wrap-up of chapter topics to help students synthesize the information.

Make Academic Connections relates chapter concepts to the "four core" curriculum areas of Language Arts, Math, Science, and Social Studies.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Supplements for Complete Instruction!

Supplements

Text	978-0-840-05829-4
Annotated Instructor's Edition	978-0-840-05864-5
Student Workbook	978-0-840-05865-2
ExamView	978-1-111-42570-8
Instructor's Resource CD	978-0-840-05870-6
Website	978-1-111-47767-7

Spanish Supplements

Glossary of Student Edition terms has been translated into Spanish to help ELL students master the important terminology associated with personal financial literacy.

NEW! Spanish Guided Practice CD is a new teacher resource which provides Spanish speaking students with Student Workbook questions and activities in Spanish to support learning. Teachers may print out and assign questions and activities to deliver personalized, differentiated instruction to every ELL student.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 1

How Your Choices Affect Income

1-1 Personal Skills and the Job Market

1-2 The Economy and Your Education

1-3 Job Application Skills and Tools

©Andresr, 2010/Used under license from Shutterstock.com

The choices you make now while you are still in school will affect your income later in life. The personal values and goals that you set for yourself will influence the way you will prepare for your future, from education to job skills. You must also consider the economy and how it will affect your decisions. And as you make those choices, you will need to consider how you will pay for the training and skills you will need to enter the job market. Having a good resume and job-hunting skills will enhance your opportunities to successfully enter and excel in the career of your choice.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Games
Chapter 1 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-1 Personal Skills and the Job Market

GOALS

- Discuss the job market, how it changes over time, and what you can do to prepare yourself.
- Describe how your education may affect the amount of money that you earn.

KEY TERMS

- job market, p. 2
- skill set, p. 2
- hard skills, p. 2
- soft skills, p. 2
- job description, p. 5
- value, p. 6
- goal, p. 6
- on-the-job training, p. 7
- self-training, p. 7

What Is the Job Market?

job market the job openings that are available when you are ready to go to work

The **job market** refers to the job openings that are available when you are ready to go to work. It is ever changing to meet the needs of employers with job openings.

In today's job market, it will be important for you to have the right skills and be able to learn new ones when they are needed. Change is a vital part of all aspects of life, and the job market is no exception. The unique skills and abilities that you bring to the job market are called your **skill set**. Within your skill set are specific technical abilities, called **hard skills**, which are measurable physical and mental abilities that allow you to complete a job. Examples include:

skill set the unique skills and abilities that you bring to the job market

hard skills measurable physical and mental abilities that allow you to complete a job

- installing a faucet
- preparing a spreadsheet
- operating a machine
- driving a vehicle

How can you learn soft skills?

soft skills nontechnical skills needed by most workers for success on the job

Being able to work well with others is also important. **Soft skills** are nontechnical skills needed by most workers for success on the job. Soft skills are an important part of your skill set. Examples include:

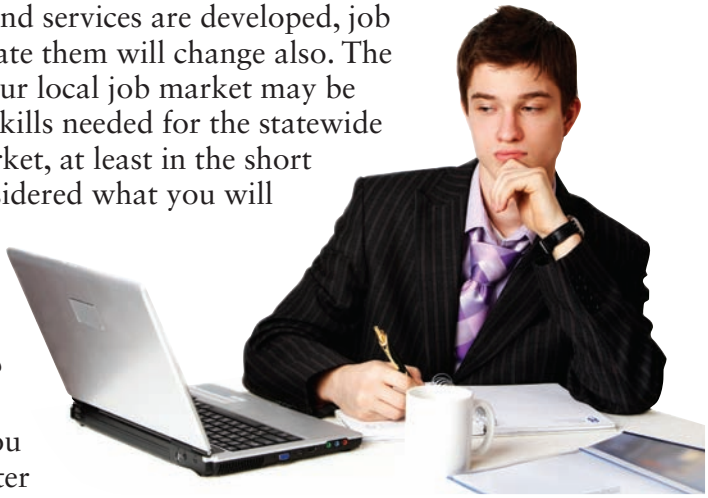
- leadership skills
- effective communication skills
- teamwork skills
- problem-solving skills
- time-management skills

Some people have natural soft skills, such as leadership, while others do not. Soft skills can be learned through education and practice. As you pursue the learning of hard skills, you also need to develop soft skills that will help you be successful on the job and in other areas of your life. Having both good hard skills and good soft skills will improve your earnings potential.

©R. Gino Santa Maria, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

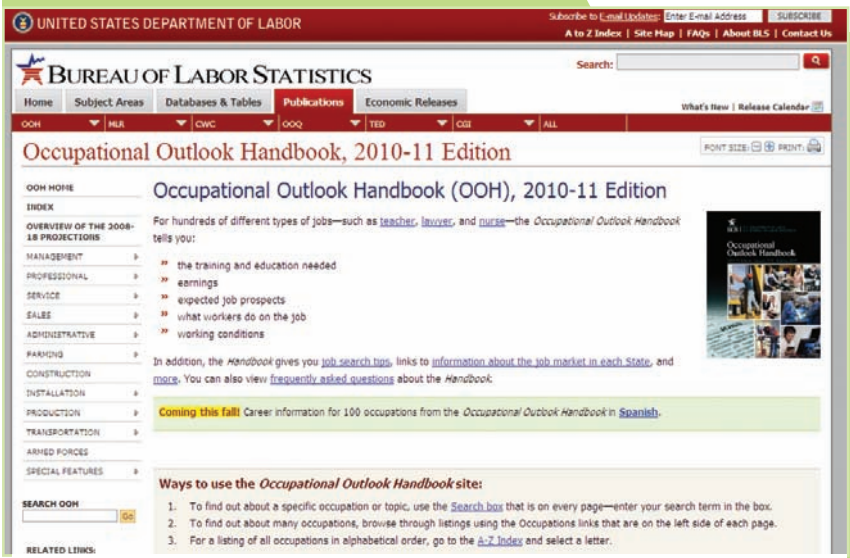
As new goods and services are developed, job skills needed to create them will change also. The skills needed for your local job market may be different from the skills needed for the statewide or national job market, at least in the short run. Have you considered what you will need to know and be able to do in order to get a good-paying job in today's job market? As you think about the type of work you would like to do later in life, consider the jobs that may exist in the future. Will the type of work you want to do still exist? If so, will this type of work pay well? You might begin asking questions and reading about jobs that sound interesting to you. You can also do online or library research about those careers.



Why is it important to learn about the job market?

A good place to start job market research is the *Occupational Outlook Handbook (OOH)*. It is published by the U.S. Department of Labor and is available online, as shown in Figure 1-1.1. From this resource, you can learn the latest about jobs in a wide range of fields. The 2010–11 edition provides job projections in 11 career areas that include management, professional, service, sales, administrative, farming, construction, installation, production, transportation, and armed forces careers. Which of these career fields sounds most interesting to you?

Figure 1-1.1 Occupational Outlook Handbook Web Page



Source: United States Department of Labor, Bureau of Labor Statistics, *Occupational Outlook Handbook*, 2010–11 Edition, http://www.bls.gov/OCO.

©fotum, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

JOB CHOICES AFFECT YOUR INCOME

Some jobs pay a lot more than others and are in greater demand. Generally, the more your skill set is filled with experience, training, and education, the more you can expect to earn. For example, a doctor must have many years of education and training to qualify as a primary care physician. Typically, doctors are well paid. A salesclerk may need only a high school education and some on-the-job training to prepare for an entry-level job. A salesclerk typically earns a much lower salary than a doctor. Look in the current *OOH* for a listing of average earnings and starting salaries for a wide range of occupations.

Today's most popular careers often require a bachelor's degree or more. Figure 1-1.2 is a short list taken from the current *OOH*, listing the fastest-growing occupations, all of which require more than a high school diploma.

The number of jobs in a career area can also affect the income level of those working in that field. When many workers compete for a few jobs, salaries are driven down, and some applicants will likely not find jobs in their chosen career area.

There are careers that don't have high education requirements. As an entertainer, supermodel, musician, or professional athlete, you may make large sums of money.

Why is your level of education an important factor in your job choice?

Figure 1-1.2 Fastest-Growing Occupations, 2008–18

Occupation	Expected Growth 2008–18	Education Required
Biomedical engineers	72%	Bachelor's degree
Network, systems and communications analysts	53%	Bachelor's degree
Home health aides	50%	Short-term training and on-the-job experience
Financial examiners	46%	Bachelor's degree
Medical scientists	41%	Doctoral degree
Physician assistants	39%	Master's degree
Skin care specialists	38%	Post-secondary skills

Source: United States Department of Labor, Bureau of Labor Statistics, http://stats.bls.gov/emp/ep_table_103.htm#.

©Kurhan, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

However, these types of careers often last just a few years. They may require natural talent, beauty, or athletic ability that few people have. They can also be very hard on the mind or body. For every person who succeeds in such a career, many others do not.

Learning about Job Requirements

As you look for information about careers, you will see jobs listed by title. A *job title* is a name given to a particular job. It may be a word or phrase that describes the main duties or tasks of the job. For example, the job title *Long-Haul Truck Driver* indicates clearly what the job involves. A person with this job drives a truck for long distances.

Sometimes a job title alone is not enough to tell you what a person in that job is required to do. For example, reading the job title *Systems Analyst* might leave you wondering what a person would do in that job. A **job description** (called "nature of the work" in the *OOH*) describes what a job would be like, including the tasks performed and skills needed. It often contains other information, such as education or experience required, the hours worked, or details about the work site or location. Figure 1-1.3 is a job description for a physician assistant, a very popular and growing career field today.

job description describes what a job would be like, including tasks performed and skills needed

Preparing for Lifelong Learning

Learning new skills and information to help you stay qualified for a job is important for your job security. When you are hired for a job, you will

Figure 1-1.3 Job Description

Physician Assistant

Nature of the Work

Physician assistants (PAs) practice medicine under the supervision of physicians and surgeons. They should not be confused with medical assistants, who perform routine clinical and clerical tasks. PAs are formally trained to provide diagnostic, therapeutic, and preventive healthcare services, as delegated by a physician. Working as members of a healthcare team, they take medical histories, examine and treat patients, order and interpret laboratory tests and x rays, and make diagnoses. They also treat minor injuries by suturing, splinting, and casting. PAs record progress notes, instruct and counsel patients, and order or carry out therapy. PAs also may prescribe certain medications. In some establishments, a PA is responsible for managerial duties, such as ordering medical supplies or equipment and supervising medical technicians and assistants.

PAs work under the supervision of a physician. However, PAs may be principal care providers in rural or inner-city clinics. In such cases, the PA confers with the supervising physician and other medical professionals as needed and as required by law. PAs also may make house calls or go to hospitals and nursing care facilities to check on patients. Many PAs work in primary care specialties, such as general internal medicine, pediatrics, and family medicine.

A PA's work schedule will vary according to the type of medical practice. PAs in clinics usually work a standard 40-hour workweek. Hospital-based PAs may be required to work weekends, nights, or early morning hours.

Source: United States Department of Labor, Bureau of Labor Statistics, *Occupational Outlook Handbook*, 2010–11 Edition, http://www.bls.gov/oco/ocos081.htm.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Ken Hurst, 2010/Used under license from Shutterstock.com

If you value a certain trait, such as physical fitness, how might it affect your job choices?

probably have the education and skills you need to do that job. As time goes by, however, new technology and advances made in your career field may cause the skills or education needed for the job to change. You will need to update your job skills. *Life-long learning* will help prepare you to be a skilled worker and an informed consumer.

VALUES AND GOALS AFFECT YOUR JOB CHOICES

value a principle that reflects the worth you place on an idea or action

As you think about a career that you might pursue, consider the values and goals that are important to you. A **value** is a principle that reflects the worth you place on an idea or action. For example, if you think being honest is important, *honesty* would be one of your values.

Values are important. They define who you are. They influence the choices and decisions you make. Think about what you want to accomplish now and later in life. For example, if you think making a difference in other people's lives is important, then that value could be a reason for choosing one job over another. You might choose to be a teacher or a counselor rather than a salesperson or accountant.

goal a desired outcome based on one's values for which a plan of action is carried out

Many people set goals that they want to accomplish. A **goal** is a desired outcome based on one's values for which a plan of action is carried out. A person's goals affect his or her behavior. If you value good health, your goals may include eating properly and exercising regularly. If you want to buy a digital camera, your goal may be to save enough money for the purchase. What goals do you want to accomplish? Can you relate these goals to your values?

CHECKPOINT ▸ ▸ ▸

How are hard skills different from soft skills?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Does Education Affect Your Income?

Some jobs require little education. Other jobs require training that takes several years to complete. Education helps prepare you to do a job well. Education can be formal or informal. *Formal education* involves attending classes and, often, earning a degree. Students must show that they have learned certain skills and concepts. *Informal education* usually does not happen in classrooms; it is often a part of working. An example of informal education is **on-the-job training**, or learning as you do the work. Another example is learning new skills from reading and practicing on your own, called **self-training**. Learning to use a digital camera by reading the instructions or teaching yourself a computer program using written or video tutorials are examples of self-training. These skills can also be listed on a resume when you are able to perform them at an acceptable level.

©Andrew Taylor, 2010/Used under license from Shutterstock.com

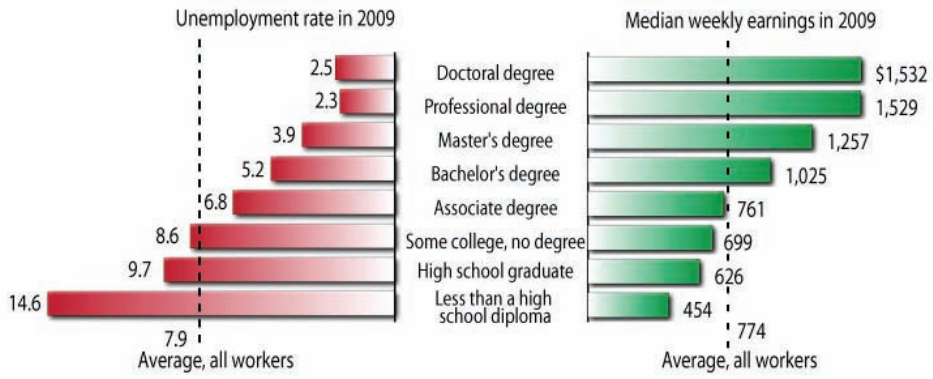
How are education and training related to a job's salary or worth to an employer?

on-the-job training learning as you do the work

self-training learning new skills from reading and practicing on your own

The amount and type of education you complete can affect the amount of money you earn. Generally, people who have a formal education earn more than people who have less education. Figure 1-1.4 shows you the difference you can expect to find in your earnings potential when you complete more formal education. If the pay for a job is high compared to the education required, there is often a reason.

Figure 1-1.4 Education Pays



Source: United States Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/emp/ep_chart_001.htm.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

LISTENING

Listening is one of the four basic communications skills (listening, reading, speaking, and writing). While hearing is easy, most people have to work at being good listeners. Listening is not the same thing as hearing. *Hearing* is the ability to process sounds. Anyone who is not hearing-impaired is able to hear. *Listening* means that information is heard and understood or thought about. According to the International Listening Association, 85 percent of what we know we have learned by listening.

Listening is an important skill that will help you succeed at school and at work. Practice these tips to help you improve your listening skills:

- Face and look directly at the person who is talking to you.
- Focus on what the speaker is saying. Do not let your mind wander to other topics.
- Ignore distractions such as noises made by other people in the room or someone passing by.
- Turn off (or unplug) the phone and eliminate other noises such as music, if possible.
- When you are part of a group that the speaker is addressing, take notes about what the speaker is saying. Write only key phrases or main ideas. Do not try to write every word the speaker says.
- In conversations with one or two people, give small feedback cues, such as "I see" or "Then what?" to let the speaker know you are listening. Nod frequently and wait quietly during pauses.
- Mentally summarize the main points of what you have heard. Ask the speaker questions to clarify points you do not understand. If you are listening to someone give you instructions for a task, repeat key phrases to review the important points.

Try It Out

1. Ask the person next to you to tell you about his or her most admired celebrity, public figure, or hero. Practice listening skills listed above. Next, it is your turn.
2. After you have finished listening to each other, write down five new things you learned from listening to the other person. List three listening skills you used during the activity.

The job might require high personal risks, a short career span, or completing tasks that others are not willing to do. For example, the employee might have to handle dangerous materials or work in an unstable country where a war is taking place.

Think about the type of education you want to complete and how well it will prepare you for the career or job you want later in life. Making choices about education is a serious responsibility. Education is considered an investment in your future. The jobs you choose and the education you receive will affect the amount of money you are able to earn. How much time and effort are you willing to put forth to prepare for the job you want? It's never too early to start planning for your future.

CHECKPOINT ▸ ▸ ▸

How is formal education different from informal education?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. The unique skills and abilities you bring to the job market

____ 2. A desired outcome based on one's values for which a plan of action is carried out

____ 3. Job openings that are available when you are ready to go to work

____ 4. Learning new skills on your own by reading and practicing

____ 5. A description of what a job would be like

____ 6. A principle that reflects the worth you place on an idea or action

____ 7. Measurable physical and mental abilities that allow you to complete a job

____ 8. Nontechnical skills needed by most workers for success on the job

a. goal
b. hard skills
c. job description
d. job market
e. on-the-job training
f. self-training
g. skill set
h. soft skills
i. value

CHECK YOUR UNDERSTANDING

9. Why does the job market change over time?
10. What is meant by a skill set? List three things you plan to have in your skill set.
11. Explain why soft skills are important. List three soft skills that are critical to job success.
12. What information is found in the *Occupational Outlook Handbook*?
13. Describe the contents of a job description.
14. Explain why lifelong learning is important to your career plans.
15. Give an example of how a person's goals and values may affect his or her career choices.
16. Explain why some career choices require little formal education while others require a master's degree or more.
17. What is meant by formal education? What is meant by informal education? Give two examples of informal education.
18. Explain how job choices affect income.
19. Explain why listening is an important skill for job success.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Today, successful career planning depends not only on finding yourself, but in creating yourself. As you explore the types of careers you would like to pursue, think of ways you can stand out from your competition to get hired for the job. Are there things you can do now, while you are still in school, to enhance your skills for a future career? Describe what you can do.
21. Soft skills are often more difficult to learn than hard skills. Being able to get along with others, public speaking and listening are important soft skills. List three soft skills on which you need to work. What can you do to improve in these areas and make them your strengths?
22. Why do actors, athletes, and entertainers make so much money when the education level they attain is often very low? Explain the qualities you need to possess and the things you would have to do in order to prepare for such a career.
23. List three values that are important to you and that are reflected in choices you make. Based on these values, list three goals you wish to achieve by the time you are 30. What careers would you consider that reflect your values and goals? Explain how your values and goals influence the personal choices you make.
24. Many people appear to be very unhappy in the careers they have chosen, yet they are unwilling (or unable) to start over in a career that would be better suited for them. How do you know when people are unhappy in their jobs (what signs do you see)? Why do you think they are so unhappy? What can you do to keep this from happening to you?

EXTEND YOUR LEARNING

25. The website that accompanies this textbook contains data files, games, links to other sites, and additional information that you will use as you complete required activities for this course. You will probably visit the site often. In this activity, you will explore the site. You will also create a link to make visiting the site quick and easy.
    - Access the Internet. Enter the following address in your web browser's address box: **www.cengage.com/school/pfinance/pfl**.
    - From the home page, click a hyperlink such as *Student Resources*. Quickly scan the new page to see the information that it provides. Click the *Back* button to return to the home page.
    - Find and click on *Web Links*. This page contains links to other sites that provide additional information related to the topics in the chapter.
    - Return to the home page. Add the website to your Favorites or Bookmarks list. Use this Favorites or Bookmarks link whenever you need to visit the site for later activities.

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-2 The Economy and Your Education

GOALS

- Describe how the economy can affect prices and income.
- Discuss the costs of and options for higher education and post-secondary training.
- Explain how to pay for college and other education programs.

KEY TERMS

- economy, p. 11
- market economy, p. 11
- demand, p. 11
- supply, p. 11
- business cycle, p. 12
- tuition, p. 13
- financial aid, p. 16
- grant, p. 16
- subsidized student loan, p. 17
- scholarship, p. 17
- ethics, p. 18

What Is the Economy?

Regardless of where you live, you are affected by the economy. The **economy** refers to all of the activities related to making and distributing goods and services in a geographic area or country. An *economist* is a person who studies the economy. *Economics* is a study of how choices are made by individuals and societies.

economy all of the activities related to making and distributing goods and services in a geographic area or country

The study of economics is also said to be the study of *scarcity*, which occurs because people's needs and wants are unlimited, while resources are limited. For example, resources, such as a person's income or the materials needed to produce products, are limited. Because these resources are scarce, businesses and individuals must make choices to meet needs and wants.

As an individual, you are faced with many choices. As you consider what to do and how to prepare for your future, you must also consider the economy. The economy will affect your income, and your income will affect the choices you make.

THE ECONOMY AFFECTS PRICES

The United States has a **market economy**, which is based on the laws of supply and demand. In a market economy, the price for an item is set at a point that consumers are willing to pay and sellers are willing to accept. In other words, sellers charge what the market will bear. Producers wish to increase their profits. Consumers wish to get high value for each dollar spent. The willingness and ability of consumers to buy goods and services is called **demand**. The quantity of goods and services that producers are willing and able to provide is called **supply**. When demand exceeds supply, businesses can charge higher prices for the products. These prices affect your decisions on which items to buy as you spend your income. The market economy works well because both consumers and producers are acting in their own best interests.

market economy an economy based on the laws of supply and demand

demand the willingness and ability of consumers to buy goods and services

supply the quantity of goods and services that producers are willing and able to provide

THE ECONOMY AFFECTS INCOME

For many people, their main source of income is wages (hourly pay) or monthly salary. If you choose to work in a career field that is growing

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

and in a job that is in demand, you will likely be able to earn a good income. The money earned allows workers to meet basic needs and other goals.

When the economy is growing, people are buying goods and services. Jobs are being created, and businesses are hiring workers. Employers are more likely to give pay raises and bonuses to employees. Finding and keeping a job that will provide financial security is easier in a growing economy.

On the other hand, when the economy is slowing, people often buy fewer goods and services. The lower demand for goods and services may mean that businesses are not growing. Workers may be laid off or dismissed from their jobs and are less likely to receive pay increases. Fewer new workers are hired. Finding and keeping a job can be more difficult in a slowing economy.

When the demand for products or services that are produced by your employer is very low, your job may be in danger. When faced with this situation, some people decide to prepare for a new career field. This process is called *retraining*. Others will spend weeks or months pursuing job openings for which their skills and education may not be good matches. They may or may not find a new job without getting new training.

Understanding how the economy affects prices of products, the job market, and your income can help you make better financial decisions.

business cycle the alternating periods of growth and decline in the economy

©Yuri Arcurs, 2010/Used under license from Shutterstock.com

How does the economy affect your spending habits?

THE ECONOMY IN ACTION

The **business cycle** is the alternating periods of growth and decline in the economy, which may be displayed graphically as shown in Figure 1-2.1. Over time, there are many ups and downs that are certain to happen. It is important to understand what each point in the cycle means and how you should prepare and respond to it. Should you buy or sell? What strategies can you use to make better choices?

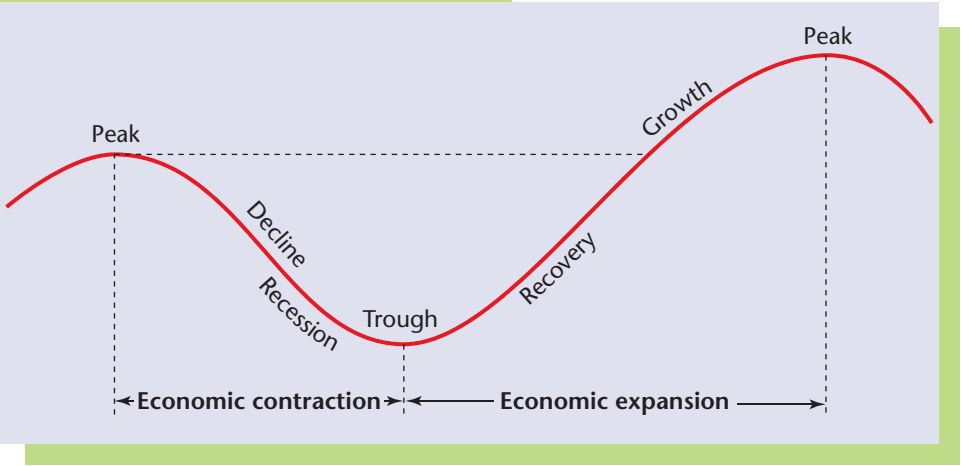
Figure 1-2.1 shows the four stages of a business cycle: recovery (growth), peak, recession (decline), and trough. During periods of *recovery*, the economy is growing. People are spending money because they are optimistic and times are good. Businesses are hiring, and factories are increasing production of goods. Rather than spending, now is the time to save money.

It is difficult to know when the economy has reached its *peak*, which is the point at which the economy is as robust as it can get. At this point, prices are high because demand is high.

When people slow their buying and are unable to pay high prices, the economy slips into an *economic decline*, called a *recession*. In a recession, jobs are being lost, production is slowing, and people are pessimistic. As people spend less money, the economy slows down even more. It's during economic declines that the money you saved

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 1-2.1 The Business Cycle



during the growth phase can buy you the most. You will get the best prices (values) because you have the cash to spend.

When the bottom is reached, called the *trough*, the economy is at a standstill. The trough remains until people start spending again, businesses start hiring workers, and production of goods once again begins to increase. You'll recognize the end of a trough when people are feeling optimistic again and businesses are hiring workers.

You need to be able to recognize these stages and determine what you can expect the economy to do next. Business cycles happen consistently over time. Based on your own analysis, you will make better choices. Your choices will allow you to spend money when you can get the greatest value and to save money for the bad times.

CHECKPOINT

Explain how the economy affects the amount of income you will make.

What Are the Costs of Education?

One of the first choices you need to consider is how to prepare for the career you wish to pursue. For many people, this means investing both time and money in an education. **Tuition** is the expense paid by students for the instruction at a school. Students must pay for textbooks and meet other expenses that are not covered in tuition. *Fees* are charged to cover special expenses of education programs, such as technology, specialized equipment, or supplies. Money is also needed for living expenses such as food, rent, clothing, and transportation. Some schools have housing for students. At other schools, students must find housing on their own. Typically, students want to live near the school. Rent and other costs may be higher in those areas.

tuition the expense paid by students for the instruction at a school

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Lisa F. Young, 2010/Used under license from Shutterstock.com

How will a formal education give you many advantages over your lifetime?

PUBLIC OR PRIVATE EDUCATION

The cost of attending a public college or university is usually less than the cost of a private school. A *bachelor's degree* is earned in a four-year college or university program. At a public college or university, earning a bachelor's degree could cost $25,000 or more in tuition. At a private college or university, the tuition may be $100,000 or more. Many top universities are charging $50,000 or more in tuition per year.

Typically, public colleges and universities are in high demand because tuition is less expensive. Tuition is less at public schools because they are also supported by state tax dollars. It may be easier to gain admittance to a private college because enrollment is lower. You are likely to find smaller classes and more personalized attention at a private college. You should check out private schools carefully to be sure they offer the same or better quality programs, degrees, and class offerings as found in public schools. A college or university is *accredited* when it is certified to meet educational quality standards.

You will need to do well in high school and achieve a good score on the SAT or ACT tests to ensure acceptance by a college or university. These tests indicate how well you are prepared for college-level classes. They measure your reading and comprehension skills, along with vocabulary, math, and English skills.

Many students find it desirable (and less expensive) to attend community colleges. An *associate's degree* is commonly earned at community colleges after two years of study. Admission tests aren't required for

NETBookmark

College and university tuition prices vary widely in different parts of the country. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 1. Which region of the country has the highest average published tuition/fees for public four-year colleges? Which has the lowest prices? Now find the average tuition/fee for a private four-year college in your area. Is it higher or lower than you expected?

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

STUDENT ORGANIZATIONS

Students in high school and college may join career-related organizations. One such organization for business students in junior high and high school is FBLA (Future Business Leaders of America). The college level of this organization is Phi Beta Lambda. Another group, the Future Educators Association (FEA), provides opportunities for high school students to explore careers in education. The National FFA Organization is for students interested in careers in agriculture. These are just a few of the many student organizations that may be available to you. Being a member of a student organization provides opportunities for students to:

- Explore careers of interest.
- Ask questions of people who are working in the career area.
- Take part in conferences to learn more about careers in those areas.
- Compete with other students to demonstrate skills learned.
- Apply for scholarships, grants, and other forms of financial aid.
- Learn about continuing education in the field.
- Take part in community service activities.
- Network and form friendships with others who have similar interests.

Student organizations usually have bylaws (rules). These bylaws outline the club's purpose and structure. The costs and requirements for membership in the group are also given. Many student organizations provide information about their goals and activities on a website.

Try It Out

Search the Internet using the keyword *student organization* and a career area (such as *nursing*) to find groups that interest you. Write a one-page report describing one of the student organizations and why it appeals to you.

community colleges, and typically, tuition costs are half or less of what you would pay at public colleges and universities.

CAREER AND TECHNICAL SCHOOLS

Career and technical schools teach specific skills. These schools may be public or private. The tuition for public schools is often less than for private schools. Public technical programs often cost $5,000 or less in tuition. Private programs usually cost two or three times as much. The completion time for career and technical school programs is often less than for college programs. Typical career and technical school programs last a few months to a year or more. Books must be paid for, along with living expenses. Students are also responsible for fees and other charges.

GRADUATE AND ADVANCED PROGRAMS

Some jobs require advanced training. For example, a medical doctor needs advanced training beyond a four-year college degree before he or she can practice medicine. Some jobs also require that you update skills

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

as you continue working. If advanced degrees are needed in the job you choose, you should consider their cost.

A *master's degree* is a graduate degree (beyond a bachelor's degree). It usually requires one to three years of additional study. The time needed depends on your background and the type of degree. A *doctorate degree* requires three to seven years of study beyond a master's degree in the same field. The course of study often requires doing research. Some programs require internships or have residency requirements. *Residency* means that classes must be taken in person on campus or at a specific facility, such as at a hospital for medical training. Tuition is higher at the graduate level. A graduate degree may cost $25,000 or more at a public school and $60,000 or more at a private school.

CHECKPOINT

What is the SAT and why is it important?

How Will You Pay for Education and Training?

When you choose to pursue formal education and training, you must consider ways to pay the cost. Do you or your parents have the money needed? Will you be able to get grants or scholarships? Do you qualify for financial aid? Will you work part time to earn money as you attend classes? These options and others may be available to you.

LOANS AND GRANTS

financial aid money you receive from an outside source to help pay for education

grant money given to pay for educational expenses that does not have to be repaid

Financial aid is money you receive from some outside source to help pay for education. Loans and grants are available from a variety of sources, including the federal government, local banks, and other lenders. A loan is money that you borrow and must repay. A **grant** is money given to pay for educational expenses that does not have to be repaid. The federal government gives Pell Grants based on need; many states also provide need-based grants to their resident students.

The government's Federal Student Aid Office can assist you in finding resources. It provides a form called *FAFSA* (*Free Application for Federal Student Aid*), which may be completed and submitted entirely online. For those under 23 years of age, parents must disclose their income and assets. *Assets* are money or things of value that are owned, such as a savings account, house, or car. The student's income and assets are also considered. If you are able to show that you need financial aid, then you will be eligible to receive grants and/or loans.

Interest is money paid for the use of borrowed money. In the case of a student loan, interest is the money the student pays the lender in

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

addition to the amount borrowed. Interest may be considered the cost of borrowing money. Interest charged on student loans is usually much lower than for other types of loans. A **subsidized student loan** is a loan on which interest is not charged until after you graduate. With an *unsubsidized loan*, interest is charged from the time the loan is made. With both types of loans, you do not have to begin repaying the loan until you graduate from college.

subsidized student loan a loan on which interest is not charged until the student graduates

PRIVATE STUDENT LOANS

Some private lenders, such as banks and credit unions, make loans to students. These loans typically have higher interest rates than loans from the government. These loans are unsubsidized, meaning that interest is charged from the time you take out the loan. Private loans require that you have income and a good credit history. If your income is too high to qualify for federal financial aid, a private student loan may be a good option for you. You will need to fill out an application for the loan. You may need to show tax returns and proof of income.

SCHOLARSHIPS

A **scholarship** is a gift of money or other aid (free tuition or books) awarded to a student to help pay for education. Scholarships may be available to students with high grades, strong athletic skills, or high test scores. Many scholarships are given based on need. Scholarships are available from local, state, and national organizations, including the federal government. Money from scholarships generally is not taxable.

scholarship a gift of money or other aid awarded to a student to help pay for education

Why should you consider how you will pay for your college or post-secondary education?

Scholarships vary in amounts. A *partial scholarship* may be given to pay for some educational costs. A *full scholarship* covers the entire tuition for a degree. To learn about scholarships for which you can apply, talk to a teacher or counselor. The Admissions or Financial Aid Office of the college you wish to attend can also provide information on scholarships that may be available. Search the Internet using the keyword *scholarships* to find other sources.

WORK-STUDY PROGRAMS

Both public and private colleges and universities (including technical schools and community colleges) have *work-study programs*. Students who are qualified are able to work on campus and are paid at contracted rates. Money received from the work reduces the amount of loans that must be repaid. To qualify for work-study, you must meet income

©karen roach, 2010/Used under license from Shutterstock.com

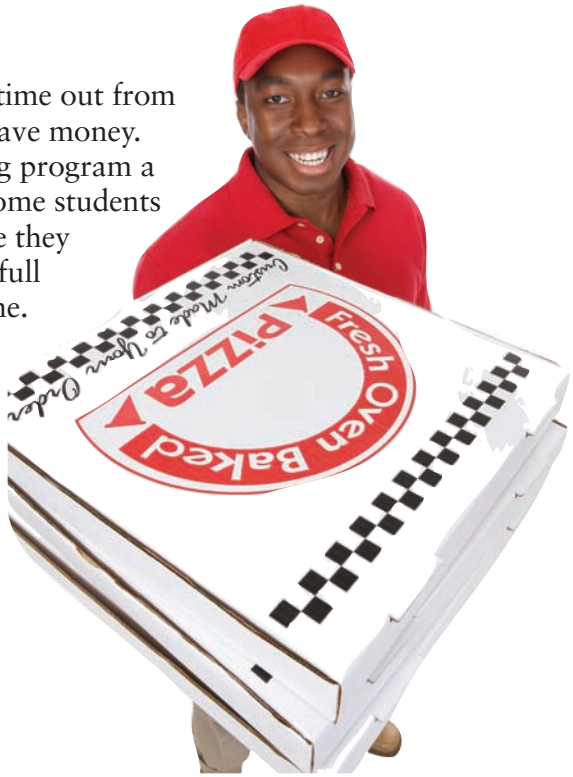
Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

requirements. You must also have the specific skills needed to do the job tasks that are assigned.

WORK AND SAVE

Some students decide to take time out from their education to work and save money. They start college or a training program a few years after high school. Some students continue their education while they work part time. Others work full time and take courses part time. This often means taking night classes or online classes.

These paths take a longer period of time to complete. However, a benefit may be the job experience students will gain as they work to pay for their education. Another benefit to students is being able to avoid the burden of a large student loan debt from financing their education.



Would you be willing to work while you are attending college classes? Why or why not?

Unfortunately, going to school part time will often delay graduation for several years. This means it will take longer to enter the job market with your degree. Also, by attending school part time, students may miss out on college activities, clubs, study groups, and other events that are a part of a college education.

ETHICAL CONSIDERATIONS WHEN APPLYING FOR AID

When writing scholarship applications or applying for financial aid, many people are less than truthful. It's a better idea not to exaggerate or give information that will create false impressions. Doing so is not ethical.

ethics a set of moral values that people consider acceptable; the study of what is right versus wrong

Ethics refers to a set of moral values that people consider acceptable. The term is also applied to the study of what is right versus wrong. Being fair and honest in your dealings with others is considered ethical behavior.

Always be truthful when completing forms. Fill in all the blanks and boxes on the form. Use *N/A* if the information is *not available* or *not applicable*. Print data clearly. When possible, download the document to your computer and key the information into the form. Double-check the data you have entered. Make sure the information is clear, complete, correct, and truthful.

CHECKPOINT ▸ ▸ ▸

How is a loan different from a grant?

©Stephen Coburn, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. The willingness and ability of consumers to buy goods and services

____ 2. A gift of money or other aid awarded to a student to help pay for education

____ 3. A loan on which interest is not charged until you graduate

____ 4. All of the activities related to making and distributing goods and services

____ 5. Money given to pay for educational expenses that does not have to be repaid

____ 6. Quantity of goods and services that producers are willing to provide

____ 7. An economy based on the laws of supply and demand

____ 8. The alternating periods of growth and decline in the economy

____ 9. Money received from an outside source to help pay for education

a. business cycle
b. demand
c. economy
d. ethics
e. financial aid
f. grant
g. market economy
h. scholarship
i. subsidized student loan
j. supply
k. tuition

CHECK YOUR UNDERSTANDING

10. What is the economy? Why is it important for you to understand it?
11. Explain the concepts of supply and demand within a market economy.
12. How may a growing economy affect your job and income?
13. What is the business cycle? List the four stages of the business cycle.
14. How does the business cycle affect you as an individual?
15. Explain why people tend to spend more money during economic growth.
16. Explain why it is important to have cash (spending power) in a recession.
17. List ways students can pay for their formal education after high school.
18. How is tuition different from fees?
19. Why is it important to attend an accredited college?
20. How is a subsidized student loan different from an unsubsidized loan?
21. What is meant by *work-study*?
22. What are the advantages of working and paying expenses as you go to college? What are the disadvantages?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

23. Describe the U.S. economy at this time. Do economists believe it is in recovery (growth), at the peak, in economic decline (recession), or in the trough? Explain what you will do at this point to better prepare for the next stage of the business cycle.
24. During a recessionary period, people lose their jobs and are unable to pay their bills. Credit card companies, which take losses because their customers cannot pay, raise interest rates and minimum payment amounts, even for those who have been excellent customers. What can consumers do to protect themselves from paying more in interest during bad economic times?
25. Why is the cost of a private education usually much higher than a public education? Why do people choose to go to private colleges? If you could go anywhere, what college or university would you choose? Why?

EXTEND YOUR LEARNING

26. You may want to apply for financial aid to continue your education when you finish high school. To learn about the information you will need to provide on the application, explore the federal financial aid form.
    a. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 1. Open the file *CH01 Aid Form* from the data files. This file contains the FAFSA worksheet for 2010–11. Your teacher may provide you with a form for the current year to use instead of this form. *Note*: The form is provided as a PDF (portable document format) file. You will need the program Adobe® Reader® to view and print the file. This program is standard on most computers. If it is not on your computer, you may follow the links on the website to download it for free.
    b. Review the FAFSA worksheet. It will help you to compile the information you will need to apply for aid online. How many pages long is the worksheet?
    c. What types of questions are asked on the worksheet?
    d. Who should complete this worksheet?
    e. What is the earliest date the FAFSA form may be completed online according to this worksheet?
27. The Internet is a worldwide network of computers that can share information. It allows users to find and share information about many topics, including the economy. Visit the website of the U.S. Bureau of Economic Analysis (BEA) at www.bea.gov to see what the experts are saying about the economy. Read some of the articles and view graphs and charts. Click on the link *U.S. Economy at a Glance* and do additional web browsing. Based on your findings, how do you think the economy will affect the job market in the upcoming year?

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-3 Job Application Skills and Tools

GOALS

- Discuss strategies to find and apply for jobs in the Internet age.
- Explain how to prepare a resume and a cover letter.
- Describe successful job application and interview strategies.

KEY TERMS

- contact, p. 21
- social network, p. 21
- job shadowing, p. 22
- headhunter, p. 24
- temp agency, p. 24
- resume, p. 25
- references, p. 27
- cover letter, p. 28
- job application, p. 29
- job interview, p. 29
- follow-up, p. 31

How Can You Find Job Openings?

There are many ways to find out about job openings in the Internet age. In the past, many people found jobs by reading about them in the newspaper and mailing in their applications. Today, many applicants find out about job openings through contacts, networking sites, company websites, and online career and employment sites. A **contact** is a person you know, such as a relative or friend. You may have met this person just recently, or you may have known him or her all of your life.

contact a person you know, such as a relative or friend

Many job openings are never advertised. They are filled from within the company or with people who are privately told about the job opening.

GETTING STARTED

While you are in school, you can start building your social network. A **social network** is a group of friends and acquaintances who keep in contact and share information. Many people today belong to online social networking sites, such as FaceBook, MySpace, LinkedIn, Twitter, and personal blogs. At these sites, you are able to exchange information with others, post messages, and keep in contact over time.

social network a group of friends and acquaintances who keep in contact and share information

If you are seeking a job in a field where you have no contacts, try to get to know people who can tell you about openings. Ask if they have a web page or blog and stay in touch. Start by letting others know about your skill set that makes you a unique and desirable employee.

How can you learn about job openings that aren't advertised?

If you are working, even on a part-time or volunteer basis, keep others informed and talk to them often. This includes coworkers,

©Franck Boston, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

USING SOCIAL NETWORKING SITES

Using the Internet for social networking has many advantages for job seekers, such as a wide range of sources for job information, up-to-the-minute knowledge, and rapid response to job openings. But it can also be a risky place if you are not careful. Here are some do's and don'ts for using Internet social networking sites.

Do:

- Be courteous and thoughtful
- Be appreciative when you get good information
- Follow through and do your best when others recommend you
- Share information that benefits others
- Proofread very carefully before posting information
- Read your postings from others' points of view

Don't:

- Criticize or be negative about others
- Complain about your job, employer, or others
- Swear, use slang, or poor language
- Neglect others when they ask for your help
- Post information that could lead others to think poorly of you
- Brag or seem arrogant or thoughtless

Think Critically

1. If someone googled your name, what would they find? Why do employers care about what applicants and employees post on their social networks?
2. What social networking sites do you use? What kinds of information should you avoid sharing on these sites?

customers, and business professionals you will meet in the course of your employment. Share information with them as well as gather it for yourself.

It's a good idea to join student groups and community organizations. Here you will meet people who can introduce or refer you to other people.

Job Shadowing

job shadowing spending time observing a worker in a type of job that interests you

If you would like to get to know people in a particular type of job, but you have no contacts, you might consider job shadowing. **Job shadowing** is spending time observing a worker in a type of job that interests you. Many employers will let you come and visit in this manner, as long as you do not disrupt the work being done. You can see how activities are performed in a typical day. The contacts you make while job shadowing can give you the inside track on finding out about future job openings.

Cooperative Work Experience

Many schools have programs to assist students in preparing for careers, making career choices, and securing part-time or full-time work. One such program is called *cooperative work experience*, where students attend classes part of the day and then go to a job that provides supervised work. Students receive credit for the on-the-job skills they learn.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

School Counselors, Teachers, and Placement Centers

School counselors and teachers are often good sources of job opportunity information. They are often asked by employers to recommend students for specific job openings. *Placement centers* also help students find jobs. Their services are usually offered free of charge. Placement centers post job openings at the school and provide information to qualified students so they can apply. Be sure to check at your school to see what kind of assistance may be available.

CHECKING WEBSITES

Many businesses maintain websites that list job openings. You can usually find these at the "human resources" link at the business's home page. The job openings often contain a job description that lists job qualifications, timelines for applying, starting dates, and pay rates. These sites are updated frequently, so it is important to check back often. You may be able to apply for jobs online.

You can also find job postings at websites such as Jobdango, Cooljobs.com, Yahoo! HotJobs, Monster, CareerBuilder, craigslist, and Resumeblaster.com. Many local newspapers also have websites with searchable job listings. If you want to work for the government, you can learn about jobs through websites such as USA Jobs shown in Figure 1-3.1

JOB SCOUTS

Technology is changing the way people find jobs. When you are ready to begin working, you may want to use a job scout to help you find openings. A *job scout* (also called a *job agent*) is a type of computer program known as an intelligent agent. The program completes tasks using rules or options you set. In the case of a job scout, its task is to search the Internet to find job listings and to return those listings to you. The rules you set

Figure 1-3.1 USAjobs.gov

Source: United States Office of Personnel Management, USAJOBS, http://www.usajobs.gov/firsttimevisitors.asp.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

might state the type of job and the location of the job (city or state). You may choose to have the job listings sent to you daily or weekly. Using a job scout can help you find a job that will allow you to build financial security.

EMPLOYMENT AGENCIES

All major cities have public and private employment agencies. *Employment agencies* help job seekers find a job for which they are qualified. They also help employers locate the best job applicants for their openings. Private employment agencies may or may not charge a fee for their services. Some agencies charge a fee to the employer. Others divide the fee between the employer and the new employee. Fees vary from agency to agency, so you should compare prices.

How do employment agencies help fill job openings?

A **headhunter** is a type of employment specialist who seeks out highly qualified people to fill upper-level positions for an employer. For example, if a company needs a new manager or vice president, it may use a headhunter to recruit an executive with the skills and experience needed rather than advertise the job opening and go through an open interview process.

State Employment Offices

The state employment office also helps people find jobs. It does not charge fees because it is a government agency. There you can also find information about job-training and assistance programs, such as YES (Youth Employment Services), Youth Corps, Civil Service (both state and federal), and other government-sponsored programs. You may qualify for one or more of these types of work programs.

Temp Agencies

headhunter an employment specialist who seeks out highly qualified people to fill upper-level positions for an employer

temp agency an employment agency that provides part-time and full-time jobs on a temporary basis

If you initially have trouble finding a full-time or permanent job, you might consider starting at a temp agency. A temporary agency, commonly called a **temp agency**, provides part-time and full-time jobs on a temporary basis. Working in a temporary job gives you a chance to make a good impression on an employer and to expand your network. It also gives you good work experience that could be applied to other jobs. When the company sees that you are a good fit, you may be offered a permanent job. In such a case, the company will buy out your contract with the temp agency. Or, you may be hired after the contract with the temp agency is completed.

CHECKPOINT ▸ ▸ ▸

List five sources of job opening information.

©Radu Razvan, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Do You Prepare to Get a Job?

The first step toward getting a job is to prepare and have a resume, as shown in Figure 1-3.2. A **resume** is also known as a personal data sheet or a *vita*. It describes your work experience, education, skills, interests, and other qualifications (your skill set) that qualify you for a job opening. Different styles of resumes can be viewed at online career sites.

resume a summary of your work experience, education, skills, and interests that qualify you for a job opening

Figure 1-3.2 Resume

Anisa Newkirk
162 NW Marshall Street
Portland, OR 97209-4323
(971) 555-4021
anisan@internet.com

CAREER OBJECTIVE

To assist with animal training for service dog programs in the local area; desire to work with dogs on emergency and trauma response teams.

EDUCATION

Hoover High School, Portland, Oregon (graduate 2009)
GPA 3.3, Dean's List two years

Relevant Course Work:
Biology
Environmental Science
Public Speaking and Forensics

Relevant Skills:
Work well with animals
American Sign Language (ASL)
Excel (spreadsheets)
Word (word processing)

Extracurricular Activities:
Volunteer: Red Cross Emergency Response
Debate Team (two years)
Member: National Honor Society (two years)
Athletics: Tennis and volleyball

EXPERIENCE

Volunteer, Noah Animal Hospital, Portland, Oregon (one year)
Worked with injured animals, gave them food and medication; worked at the all-night emergency room, took data from animal owners; assisted veterinary staff with medical procedures.

Caregiver, County Animal Shelter (two summers)
Cared for animals; made calls to help find them new homes.

Pet Sitter/Dog Walker (two years)
Provided care for dogs, cats, rabbits, birds, and snakes while owners were away on vacation; provided daily dog walking services.

REFERENCES

Provided gladly on request.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

GENERAL RESUME GUIDELINES

When preparing a resume, there are no set rules. You should choose the style that best presents your strengths. Here are some general guidelines:

- Have a "master resume" which lists everything you have ever done. Include every job, every award, every skill, every bit of information you have.
- Tailor each resume you prepare to include the information that will best match your skill set to those skills listed in the job opening.
- Keep each tailored resume to one page. List important information in the top third of the page. It will be the first thing reviewers see, and it should grab their attention.
- Keep the resume simple, attractive, and easy to read. Carefully choose your use of fonts, boldfacing, italics, spacing, and other style elements. If your resume will be submitted electronically, avoid using formatting that might change or look different when the file is opened in a different computer operating system.
- Proofread thoroughly. It must be error-free—no keying errors, spelling errors, or grammar mistakes.
- For hard copies, avoid bright colors, odd sizes, and stained or discolored paper.

The content of your resume should include your name, address, telephone number, and e-mail address. Omit personal information such as age or ethnic background. Including a career objective is optional. After your resume gets fuller, you may wish to drop it. If used, keep it short, direct, forward-looking, and specific. Avoid statements like "any kind of work."

List your high school and any other schools you have attended, starting with the most recent. You may include areas of study, grade point average, honors, specific courses that might apply to a job opening, and other positive facts such as your involvement in extracurricular activities.

List jobs you have held, both paid and unpaid. Describe the work you have done, including the names and addresses of employers. Emphasize skills you learned and responsibilities you held. Point out any experience you may have that directly relates to the job for which you are applying.

List references to fill the space, giving their names, titles, addresses, and phone numbers. E-mail addresses can also be used. Or, if your resume is already full, just state that references "will be provided on request." Then prepare a page of references to take with you to a job interview, or to use for a job application, in case you are asked.

SCANNABLE RESUMES

Some employers use scanners and software to search for key words and phrases that match skills required in their job descriptions. They can scan hard copy as well as electronic resumes. The scan determines which resumes will be considered further.

A *scannable resume* is designed for easy reading by a scanner and contains key words from the career or job opening. To improve your chances for selection, use words that match job opening words, and use a simple, standard font. Keep it to a standard page size with headings no larger than a 14-point font. Avoid any fancy fonts, italic, underlining,

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

condensed type, shading, shadows, columns, boxes, graphics, and horizontal or vertical lines.

REFERENCES

References are people who have known you for several months to a year or longer and are willing to provide information about your skills, character, and achievements. They should be over 18 years of age and not related to you. The best references are teachers, former and current employers, advisers, counselors, coaches, and adults in business. Be sure to ask permission before listing someone as a reference.

references people who have known you and can provide information about your skills, character, and achievements

A *reference letter* is a statement of your character, abilities, and experiences that is written by someone who can be relied on to give a sincere report. It is helpful to gather and keep reference letters. Even though they may not be current, they reflect a pattern in your life. Figure 1-3.3 is an example of a reference letter.

Figure 1-3.3 Reference Letter

FARWEST TRUCK CENTER
402 First Street, NW
Eugene, OR 97402-2143

June 4, 20--

To Whom It May Concern

Re: Maribel Boswell

I have known Maribel for the past three years. She was an employee in our customer service division. Maribel began work here as an intern. She was an excellent employee, so at the end of her internship we hired her on a temporary basis. That temporary job lasted three years until Maribel moved away.

Maribel proved to be energetic and competent. She learned quickly and was a valuable member of our team. She took great pride in her work. She was able to work well independently and as a team member.

Without reservation, I can recommend Maribel to you as a potential employee. I would gladly hire her again if she were to move back to our area.

If you have any further questions, please do not hesitate to call me.

Sincerely

Harry Chen

Harry Chen
Manager

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THE COVER LETTER

cover letter a letter that accompanies a resume, introducing the applicant to a prospective employer

Whether you are submitting a hard copy, sending a resume by e-mail, or posting a resume at a website, you should also include a cover letter, as shown in Figure 1-3.4. Also known as an *application letter*, the **cover letter** serves to introduce you to a prospective employer. It gives you a chance to briefly explain or "sell" your qualifications and to make a good first impression.

The cover letter should be short and direct. In the first paragraph, you should identify your purpose—why you are writing. Be specific; tell the employer what you want (to be considered for an opening). The second or middle paragraph should point out some key qualification or skill that makes you unique. Express interest in the company. Your tone should be enthusiastic, upbeat, and friendly. The final or closing paragraph should wrap up the letter in a friendly but direct manner. Be direct; ask for an interview and specify when you are available.

Figure 1-3.4 Cover Letter

1274 Grant Avenue
Portland, OR 97224
becarter@internet.com
June 15, 20--

Mr. Jackson Phillips, Manager
Star Gaze Museum
4484 Grand Avenue
Portland, OR 97201

Dear Mr. Phillips

In response to the opening posted on your website, please consider me an applicant for the summer tour guide position at your downtown location.

As you can see from my resume, I have volunteered as a host or guide for several special events in the past. I enjoy learning new information, making presentations, interacting with people, and helping others learn new facts and ideas. Your posting indicates that you need someone to work on weekends and to be on call for extra duties. I am available and eager to work on weekends and have a flexible weekday schedule that will allow me to fit in extra duties as needs may arise.

I am available now and would love to begin work as soon as possible. You can reach me at (971) 555-3344 every day after 2 p.m. I look forward to hearing from you about an interview and discussing the tour guide position with you.

Sincerely

Brandon Carter

Brandon Carter

Enclosure: Resume

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

List the information found on a resume.

How Do You Make Yourself Stand Out?

After you have found out about job openings, you must begin the process of selling yourself as the most desirable job applicant. You must show the employer that your unique skill set is just what is needed. The job application and interview can separate you from your competition.

THE JOB APPLICATION

To apply for a job, you will most likely have to fill out a job application (also called an *employment application*). A **job application** is a form (either electronic or on paper) that asks you basic questions about your background, such as your work history (names, dates, places), education, skills, and references.

job application a form that asks basic questions about the applicant's background, such as work history, education, skills, and references

When completing a job application by hand, write neatly using a blue or black ink pen that does not skip or blot. Stay within the space provided. Fill in all the blanks. When you cannot answer a question or it isn't applicable, use the abbreviation N/A or a line (-----) to show that you have not ignored the question. Be truthful and give complete answers. Have all the needed information with you, including the names of references with their job titles, addresses, phone numbers, and e-mail addresses. When possible, take the job application form home with you and fill it out carefully at your leisure. Proofread very carefully, checking every word. Keep a copy of the form you submit.

When completing a job application online, follow the same rules. Select a standard font and proofread. You cannot rely on spell checking tools to catch all spelling and grammar errors. Be sure to print a copy for your own records. Figure 1-3.5 is a sample job application form.

©Marcin Balcerzak, 2010/Used under license from Shutterstock.com

Why is a job application important?

THE JOB INTERVIEW

The next step is the **job interview**, a face-to-face meeting with a potential employer to discuss a job opening.

job interview a face-to-face meeting with a potential employer to discuss a job opening

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 1-3.5 Job Application

EMPLOYMENT APPLICATION

Date: 7/15/20-- Job you are applying for: Clerk/Office Assistant ☐ Full Time ☒ Part Time

Social Security Number: Provided at employment

First Name: Terrell Middle Initial: B. Last Name: Adams

Mailing Address: 234 Maple Street City: Eugene State: OR ZIP: 97401

Home Phone: (503) 555-2000 Work Phone: ( ) --

Have you worked for this company before? ☐ **Yes** ☒ **No** **From:** ____ **To:** ____ **What location?**

Your name at that time: -- Position when you left: --

If you are under 18, give your birthdate: --/--/-- and work permit number (if applicable): --

Date available for work: 7/15/20--

Please indicate the hours that you are available to work on each of these days.

(Hours)	SUNDAY	MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY	SATURDAY
From	8	1	1	1	1	1	8
To	8	8	8	8	8	8	8

START WITH CURRENT OR LAST EMPLOYER—INCLUDE MONTH AND YEAR IN DATES

FROM Mo. 9 Yr. 09	COMPANY Video Image Plus		POSITION HELD Accounting Clerk BEGINNING PAY Min. Wage
TO Mo. 2 Yr. 10	STREET and NUMBER 1121 West 18th, Springfield, OR 97477	CITY and STATE	ENDING PAY Min. Wage
SUPERVISOR'S NAME Jewel Clark	TITLE CWE Coordinator	REASON FOR LEAVING end of program	
FROM Mo. 9 Yr. 08	COMPANY Madison High School		POSITION HELD Office Assistant BEGINNING PAY Volunteer
TO Mo. 6 Yr. 09	STREET and NUMBER Eugene, OR 97401	CITY and STATE	ENDING PAY Volunteer
SUPERVISOR'S NAME Andy Williamson	TITLE Office Manager	REASON FOR LEAVING end of year	
FROM Mo. 6 Yr. 04	COMPANY Register-Guard		POSITION HELD Newspaper Carrier BEGINNING PAY Commission
TO Mo. 9 Yr. 06	STREET and NUMBER Eugene, OR 97401	CITY and STATE	ENDING PAY Commission
SUPERVISOR'S NAME Mary Adamson	TITLE Supervisor	REASON FOR LEAVING to go to school	
MAY WE CONTACT YOUR PRESENT EMPLOYER? ☒ Yes ☐ No			

SCHOOL NAME	ADDRESS	FROM	TO	DEGREE/DIPLOMA
HIGH SCHOOL Madison High School	Eugene, OR 97401	2006	2010	DIPLOMA ☒ Yes ☐ No TYPE:
BUSINESS/VOCATION SCHOOL				DIPLOMA ☐ Yes ☐ No TYPE:
COMMUNITY COLLEGE/UNIVERSITY				DIPLOMA ☐ Yes ☐ No TYPE:
UNDERGRADUATE COURSEWORK EMPHASIS				CUM GPA
GRADUATE COURSEWORK EMPHASIS				CUM GPA

I understand that any offer of employment is conditioned upon the satisfactory completion of this verification process and that the complany will hire only those individuals who are legally authorized to work in the United States and who present acceptable proof of their lawful employment status and identity.

Terrell B. Adams — **SIGN HERE**

7/15/20-- — **DATE**

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

During your interview, the employer will likely have a copy of your resume, cover letter, job application, and reference letters. The interviewer may ask you about information on any of these documents or about any other job-related matters. Prepare for the job interview so you will impress the interviewer. Here are some general guidelines:

- Review your resume so you are familiar with everything you have stated about yourself.
- Rehearse open-ended questions where you talk about yourself. Be ready for questions such as, "Tell me about yourself," or "Why do you want to work for us?" Talk about your skill set and how it relates to the job opening. Practice your interviewing skills with a friend or family member.
- Lean forward, listen carefully, and show the interviewer you are interested and enthusiastic about the job opening.
- Arrive on time, or about ten minutes early. Dress appropriately, as you would if you were already on the job (or one notch better).
- Always go alone. Do not take a friend or relative.
- Appear self-confident and relaxed. Do not show tension or stress. Avoid eating or drinking, except water if it helps keep you calm.
- Be courteous, using "please" and "thank you."
- Think before you speak. Speak slowly and clearly. Use good grammar and avoid slang.
- Look directly at your interviewer(s), making eye contact frequently. Smile often and show confidence.
- Watch for clues that you should talk more or less.
- Do company research so you can speak intelligently about the company and ask meaningful questions. It is common for the interviewer to ask you what questions you might have about the company—make them impressive!

After the interview, you may wish to do some type of follow-up. **Follow-up** is contact with the prospective employer after the interview but before a person is actually hired for the opening. When it could be days or even weeks before a decision is made or announced, it could be in your best interest to remind the employer of your interest and enthusiasm.

follow-up contact with a prospective employer after the interview but before a person is hired for the opening

A thank-you letter is one form of follow-up. The *thank-you letter* shows appreciation for the time taken to interview you. It also reminds the employer of your interest. When writing a thank-you letter, keep it short and direct. You might enclose a letter of reference or remind the interviewer of a special skill or aptitude that you have. Make sure it is error-free, friendly, and appreciative.

Other forms of follow-up include a phone call or a drop-in visit where you would inquire about the status of the job opening. Be sure to dress like you already have the job. Be courteous and friendly.

CHECKPOINT

List five things you should do to have a successful job interview.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

1-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. A summary of your work experience, education, skills, and interests that qualify you for a job opening

_____ 2. A form that asks basic questions about the job applicant's background

_____ 3. An employment agency that provides jobs on a temporary basis

_____ 4. A person you know, such as a relative or friend

_____ 5. A letter that introduces the applicant to a prospective employer

_____ 6. A group of friends and acquaintances who keep in contact and share information

_____ 7. An employment specialist who seeks out highly qualified people for upper-level positions

_____ 8. Contact with a prospective employer after the interview but before a person is hired for the opening

_____ 9. Spending time observing a worker in a type of job that interests you

a. contact
b. cover letter
c. follow-up
d. headhunter
e. job application
f. job interview
g. job shadowing
h. references
i. resume
j. social network
k. temp agency

CHECK YOUR UNDERSTANDING

10. Explain the importance of contacts when you start looking for a job.
11. What are the benefits of a cooperative work experience?
12. What is a social networking site? Give three examples.
13. What is an online job posting? Where can you find them (what are some websites)?
14. List three guidelines for preparing a good resume. What kinds of information should not appear on a resume?
15. What is a scannable resume? If you are asked to send one, what guidelines should you follow?
16. What is a reference? Why are references important?
17. What is the purpose of a cover letter?
18. When filling out a job application, what should you remember to do?
19. Explain how you will prepare for a job interview, listing things you will and will not do.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Social networking sites are fun and enjoyable for most people. But employers and others do search the Web when checking out possible employees. You must be careful what you post, because it is public information. How can you protect yourself from losing jobs or not being hired because of information available on the Internet?
21. Sometimes finding job openings is about asking the right questions (of the right people) and checking websites. These sources are usually free, while employment agencies may charge for their services. List in order the steps you would take to find out about job openings. Could you save money or time by following these steps? Explain how.
22. Why is it important to participate in extracurricular activities and volunteer activities while you are still in school? These activities should be listed on your resume. Explain why employers care about these types of activities. What does your participation tell them?
23. It is often reported in news articles that "everybody exaggerates on their resumes." Do you think this is true? Do you plan to exaggerate? What could be the downside of providing false information on your resume?
24. It's important to maintain contact with people from your past, whether employers or teachers or friends. These people can be your references, attesting to your character and skills. Explain what is meant by "burning your bridges behind you" and why you should avoid this practice in good career planning.
25. The job application form contains much of the same information found on your resume—such as work history, education, and skills. Why do employers require you to fill out a form? Can you just state "see resume" rather than answering questions? Why or why not?

EXTEND YOUR LEARNING

26. Go online and search for resumes using the keywords *sample resumes*. You can find sample resumes for students, free resume templates, and other kinds of resumes online. Look at the many different types and styles of resumes. For example, a chronological resume gives your history from most recent backward. A functional resume gives your history based on particular skills you want to emphasize. Find and download at least five different styles that appeal to you. Which style appeals to you most? Why?
27. Visit the website of a local large or government employer. Look for the link to their Personnel or Human Resources Department. Click on job openings that are currently available. Print out information available about a job opening. What are the deadlines? Who can apply (what are the job qualifications)? Can you apply online? If possible, download and print a job application and fill it out for practice.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

JOURNALISM

Most people receive information about what's happening in the world from various news outlets. Journalists are the ones who find out what's new and deliver that information to us in the form we find most convenient.

Those working to bring us the news examine, interpret, and broadcast information from various sources. In covering a story, a reporter talks with people, takes notes, organizes material, writes the story, uses electronic equipment, and produces the story in its most usable form.

Most journalists work at large stations, networks, and news agencies. They gather information about newsworthy events, from accidents to business decisions, as assigned. Most journalists specialize in some area, such as crime or education. Investigative reporters cover stories for which their research may take days or even weeks. All facts in a story must be verified. The work is usually hectic, hours vary, and deadlines are key.

Employment Outlook

- Employment opportunities are expected to decline moderately through 2018. Competition will be keen.
- Small broadcast stations and online newspapers and magazines provide the best opportunities. Technical writers will have an advantage.

Job Titles

- News analyst
- Reporter

- Correspondent
- Journalist

Needed Education/Skills

- Bachelor's degree in communications, journalism, or related programs
- Most important skills are writing and communication

What's it like to work in . . . Journalism

Mary is a television reporter for a local station. She specializes in reporting "live" from the scene.

Today she is reporting on a strike at a local business, where emotions are running high. She will interview both strikers on the picket line and temporary workers brought in to fill their jobs. To be fair, she will also interview the plant manager and present the employer's side of the dispute.

Her day began when the picketers first showed up at 7 a.m. She hopes to have her story in its final form for the noon broadcast at the TV station. She will remain at the scene until she is satisfied with the information she has gathered.

What About You?

Would you enjoy fast-paced and often highly charged work? Do you like investigating until you get to the truth?

©M. Dykstra, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 1 Assessment

SUMMARY

1-1 The job market refers to the job openings available. It is continually changing.

Both hard skills and soft skills are necessary for career success.

The career you choose will affect your income over your lifetime.

Decisions and choices you make, both personal and career-oriented, are based on your values and goals.

The more formal education you gain, the more you will probably earn over your lifetime.

1-2 The economy refers to all of the activities related to making and distributing goods and services in a geographic area or country. The state of the economy will affect your job and your career in terms of earnings and job security.

Tuition and fees are some of the costs of education. Costs will vary based on the type of school (public, private, or career schools) or program selected (graduate and advanced programs).

Financial aid is money received from some outside source to help pay for education. A loan is money that is borrowed and must be repaid. A grant is money given to pay for educational expenses that does not have to be repaid. A scholarship is often awarded based on grades or athletic skill. Some students work to earn money to pay for education while attending college or a training program.

1-3 There are many ways to find out about job openings, such as through contacts, social networks, websites, job scouts, employment agencies, job shadowing, cooperative work experiences, school counselors, teachers, and placement centers.

The first step in getting a job is to prepare a resume. A resume is a summary of your work experience, education, skills, and interests that qualify you for a job opening. References may also be provided on a resume.

A cover letter usually accompanies a resume, whether in hard copy or submitted electronically. It should introduce you to the employer in a direct and friendly manner.

The job application (whether hard copy or electronic) consists of employers' questions about your education and experience.

The job interview gives you the chance to sell yourself as you answer questions about your qualifications and background. You may wish to follow up with a letter, call, or visit.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Complete these problems to build your math skills. You may use spreadsheet software or complete the problems manually. (Round up to the nearest whole dollar.)
   a. The average tuition for four-year private colleges increased by 5.9 percent from last year. The average cost last year was $20,051. What is the average cost this year?
   b. Use this year's tuition cost answer from above. If the tuition increases by 6 percent for each of the next three years, what will be the total tuition cost for the four years?
2. **Research** Work with a classmate and select a career area that interests you both. Explore programs offered at colleges by performing the following activities:
   a. Identify two or more colleges or other schools (such as career or technical schools offering a chef program or a cosmetology program) that provide training in your career area of interest.
   b. Visit the websites of at least two of the schools you listed above. To find a school's web address, enter the school name in a search engine such as Yahoo! or Google.
   c. Compare the programs offered in terms of length. How many terms or years are required to complete the program at each school?
   d. Compare tuition costs for the schools. Which has the highest tuition?
   e. Identify which program you think is the best and explain why.
3. **History** Job hunting has changed considerably over the years. Many job openings today are found only through contacts and via the Internet. Compare the current job market with the job markets of 1950 and 1990. If possible, talk to someone who was in the workforce 20 or 30 years ago. Ask how the job market has changed for women.
4. **Communication** Write three cover letters—one for an unsolicited job at a company where you would like to work (but there is no known opening); one for a job opening with a company you found on the Internet; and one for a job you learned about from a friend. How will these letters be different? Focus on content and writing style.
5. **International Studies** Conduct online research about the job application process in other countries. Choose a country in Europe and one in South America. How are the application processes different from what you find in the United States? Would you like to work in a foreign country? Why or why not? Are you qualified? Explain your answer.
6. **Communication** Have you thought about what you want to do, to be, and to have as you become an adult? Complete the following steps to help you think about your values and goals:
   a. List three goals that you would like to achieve by the time you graduate from high school.
   b. After each goal, explain why that goal is important to you. Discuss the values on which you are basing that goal.
   c. Consider how your goals have changed over time. A year ago, how were your goals different? How are they the same?
   d. Which goals do you think are lifetime goals—based on values that you think you will firmly hold through your lifetime?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

e. Do your daily choices and decisions reflect these values? List things you do (or don't do) that show you are consistent in applying your values to your choices.
f. Write a statement about your future life plans, covering career, family, travel, and lifestyle. How do these long-term plans reflect your values?
g. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 1. From the data files, open the Word file *CH01* Goals. Follow the directions in the file to complete a chart about your values and goals.

Point Your Browser

www.cengage.com/school/pfinance/pfl

Take Action

PREPARE BASIC EMPLOYMENT FORMS

For each chapter, you will complete a short project. These projects will become part of your portfolio. A portfolio is a group of work that you complete which ties together your learning and demonstrates your understanding of topics presented. As you complete this work, save it to include in your portfolio.

Based on what you learned in this chapter, prepare the following documents:

- Cover letter (assume you found out about the job opening from a posting at a company's website).
- Resume (design it for the job for which you are applying).
- Job application form (pick one up from a local employer or employment office, download one from an employer's website, or use one provided by your teacher).
- Thank-you letter (assume the successful candidate will not be announced for another two weeks).

These documents should be prepared in final form. That means you would actually use them as models for a job opening. They should be complete, accurate, and error-free and represent your current situation or what you plan to have on your resume when you apply for your first job.

Prepare answers you would give to the following commonly asked interview questions. Save your answers in your portfolio.

1. What do you see yourself doing five years from now?
2. Tell me about yourself.
3. What is your favorite hobby, and why?
4. Tell me what you do in your spare time.

Work with a partner to conduct a mock interview. Your partner should act as the interviewer and ask you the questions above. Practice giving the answers you prepared.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER

2 Income, Benefits, and Taxes

©Morgan Lane Photography, 2010/Used under license from Shutterstock.com

2-1 Earned Income and Benefits

2-2 Unearned Income and Payments

2-3 Taxes and Other Deductions

People receive income from working (wages and salaries). They can also receive income from other sources, such as investments (interest and dividends). Another source of income may be government transfer payments, which help people who do not have enough income to pay for basic needs. Workers also receive benefits such as paid vacations and sick leave. These benefits are part of the total compensation package. Various types of taxes are levied in this country, including income taxes on earnings. In this chapter, you will learn about income sources and benefits. You will also learn about taxes and how all citizens benefit from taxes collected.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Games
Chapter 2 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-1 Earned Income and Benefits

GOALS

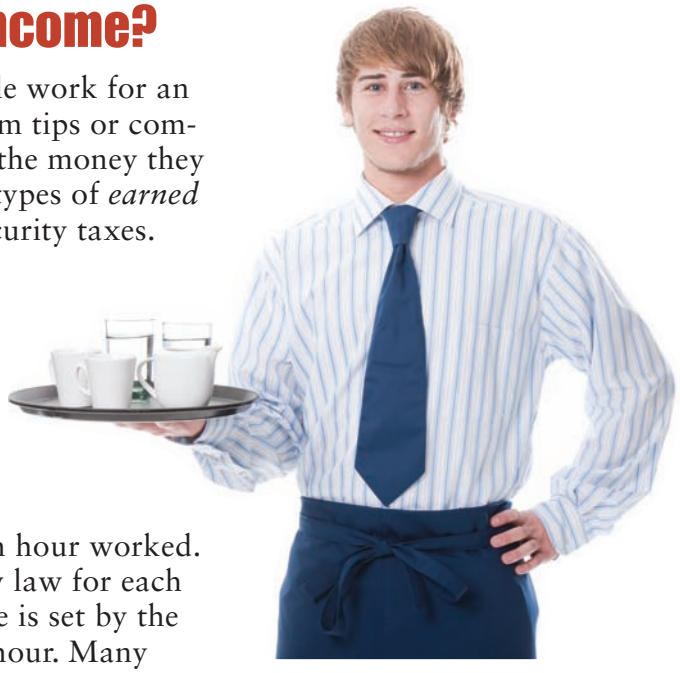
- List and discuss types of earned income, such as wages, salaries, tips, and commissions.
- Discuss the advantages and disadvantages of self-employment.
- Describe employee benefits and their role in employee compensation.

KEY TERMS

- minimum wage, p. 39
- overtime pay, p. 39
- commission, p. 41
- entrepreneur, p. 42
- benefits, p. 45
- disposable income, p. 45
- sick leave, p. 46
- personal leave, p. 46
- retirement plan, p. 47
- profit-sharing plan, p. 47

What Are Sources of Earned Income?

Many people work for hourly wages. Some people work for an annual salary. Others have additional income from tips or commissions. Some people work for themselves, and the money they earn is called self-employment income. All these types of *earned income* are subject to income taxes and social security taxes. A *tax* is a required payment for the support of a government. The tax may be based on items such as earnings, property values, or the sales price of an item. More information about taxes is provided later in this chapter.



What sources of income are available to you?

WAGES

Employees who work for wages are paid for each hour worked. **Minimum wage** is the lowest pay rate allowed by law for each regular hour of work. The federal minimum wage is set by the U.S. Congress. In 2010, that rate was $7.25 per hour. Many states have minimum wage laws that set a rate higher than the federal rate. The state minimum wage rates can be found on the U.S. Department of Labor website as shown in Figure 2-1.1. In many jobs, new employees will begin at minimum wage, because they do not yet have the education or experience to command a higher wage rate.

minimum wage the lowest pay rate allowed by law for each regular hour of work

An 8-hour day and 40-hour workweek has become the standard in the American workplace. Hours worked in addition to the standard are called overtime hours. When employees must work overtime hours, they are entitled to extra pay called **overtime pay**. By law, overtime pay must be at least 1½ times the regular rate. For example, a worker who earns $8 per hour for regular pay would earn $12 per hour ($8 × 1½) for overtime pay. People who work on holidays may be entitled to even higher pay rates for their hours. Both federal and state laws control when extra pay is required for additional time worked.

overtime pay pay received for hours worked in addition to regular hours

©matto media, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-1.1 U.S. Department of Labor Website

Source: United States Department of Labor, Wage and Hour Division, http://www.dol.gov/whd/minwage/america.htm.

SALARIES

Some people work for a set *salary*, such as $3,000 a month or $36,000 a year. Salaried workers usually do not keep time cards or count hours worked. They may have more flexibility in the times they work than do hourly workers. They often work more than 40 hours a week but do not receive overtime pay. People who work for a salary are usually self-directed. Managers and supervisors are typically paid a salary.

TIPS AND COMMISSIONS

Some workers receive tips in addition to wages. A *tip* is a gift of money, often a percentage of the total bill, to a person for performing a service.

NETBookmark

Do you tip well when you visit a restaurant or have your hair cut? Many service employees depend on tips for the bulk of their income. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 2. What is the definition of a *tipped employee*? What is the minimum required hourly wage for tipped employees?

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

TEAMWORK

During your lifetime, you will be on many teams. Whether you are taking part in a family event, a competitive sport, a work group, or a fun activity, teamwork skills will come in handy. Combining the energy of many people makes the work go faster, and the result is often more creative. When you work with others, you can achieve better results than when you work alone. Whenever you work with others to achieve a common goal, try to follow these team strategies to improve your teamwork skills:

- Set clear goals for the team. Create an action plan to achieve the goals.
- Define the duties of each team member.
- Identify how success will be measured. How will the team know it has met its goals?
- Identify problems the team may face in achieving its goals. Discuss ways to overcome them.
- Talk with all team members. Have regular meetings to track team progress.
- Build on the strength of team members. Encourage all members to help make decisions and to share ideas. Each member has different skills that add strength to the team.
- Recognize accomplishments of team members as well as the team as a whole.
- As an individual team member, earn trust by completing your duties. Show a positive attitude when discussing team activities. Be loyal to your team members.

Think Critically

1. Describe the last group (team) you worked with on a project or assignment. List the successful team strategies that resulted in success. Which ones could have been improved?
2. When you fill the role of team leader, how will you improve teamwork using the strategies listed above?

The amount of the tip may be based on the quality of service provided. For example, a waiter may receive tips in the form of money from customers. A caddy at a golf course might receive free tickets to a show as a tip. Some workers make most of their earnings from tips rather than hourly pay.

Tips are subject to federal income taxes. Tips may be subject to state taxes as well. The law requires some employers (such as restaurants and hair salons) to withhold taxes based on tips, even though tips may have been received in cash directly from customers.

Some workers are paid a commission. A **commission** is a set fee or a percentage of a sale paid to an employee instead of or in addition to salary or wages. Sales commissions are earned only when a sale is made. If no sale is made, no commission is received. In some types of jobs, such as real estate sales, the worker's entire earnings may be based on commission. For example, a real estate agent who sells a home for $200,000 might receive a $12,000 commission. In other types of jobs, workers may be paid a base salary plus commissions. For example, a person who sells cars might receive a salary of $10,500 a year plus 25 percent of the profit on each car sold.

commission a set fee or percentage of a sale paid to an employee instead of or in addition to salary or wages

CHECKPOINT

How is overtime pay different from regular pay?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Is Self-Employment?

entrepreneur a person who takes the risks of being self-employed and owning a business

Working for yourself is called *self-employment*. A person who takes the risks of being self-employed and owning a business is called an **entrepreneur**. Small businesses contribute billions of dollars to the U.S. economy and employ more workers than all of the country's large corporations combined. Owning a business can be challenging, but it can be very rewarding as well.

ADVANTAGES OF OWNING A BUSINESS

A major advantage of being the owner is that you get to make the decisions about how the business will be run. The owner can say what the business will and will not do. This includes the choice of products and services that will be offered. It also includes hours of operation, the types of customers the business will target, and the prices it will charge.

As a small business owner, you have the freedom to set your own hours, deciding when you will work and how long you will work. Small business owners also keep all the profits of the business. *Profit* is the amount left after all expenses are deducted from the revenues or sales of the business.

DISADVANTAGES OF OWNING A BUSINESS

If the business fails, the money invested in the business is lost. Most money invested in a small business comes from the owner and/or the owner's family and friends.

Owning a small business is often risky because it is hard to get credit. In many cases, the owner uses his or her personal credit, including credit cards, home equity, and loan debt in order to get and keep the business running.

With most small businesses, and especially during its first years, the owner works long hours and does many different tasks to keep the business running. Because money is often tight, owners cannot always hire others to do the work for them.

©Corbis

Would you like to own your own small business? Why or why not?

TYPES OF SMALL BUSINESSES

There are two main types of small businesses: lifestyle businesses and venture businesses. A *lifestyle business* is one where the owner intends to keep the business small. The business provides a good income for the owner and his or her family. These businesses exist for the lifetime of the owner and often have no resale value. For example, a dentist may elect to be a one-dentist office and provide services to his or her patients. When the dentist retires, the business closes. Some entrepreneurs have their businesses "on the side." This means they work a full-time job for someone else and pursue their *avocation*—a secondary occupation they enjoy—in their spare time. Their avocation may also bring them a nice "side income."

Other business owners want their businesses to grow into large companies with unlimited growth and many workers. This type of business is called a *venture business*.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

As it continues to grow, it will eventually become a corporation. For example, Phil Knight started a business designing tennis shoes in his garage in Eugene, Oregon. When the company grew, it eventually became the publicly held corporation known as Nike. A venture business owner has an "exit plan" so that others can continue operation of the business when the owner decides to leave. The business owner simply may become one of the many stockholders and will no longer have total control of the business.

GETTING STARTED IN BUSINESS

Certain cultures seem to encourage entrepreneurship more than others, and people whose parents owned small businesses are much more likely to start a business than those whose parents worked for someone else. Working for your parents and watching their example can certainly provide an edge. Many entrepreneurs start out working for other businesses in order to gain needed knowledge and experience. Many business owners seek formal and/or informal education about how to run a business before they get started.

If you have a desire to run your own business, you should spend time preparing yourself for such a venture. A good place to start is to talk with the advisers at a Small Business Development Center (SBDC). These centers are located in cities across the country and are sponsored and funded by the Small Business Administration (SBA). A visit to the SBA's website can help you get started asking the right questions. Figure 2-1.2 shows the website for the SBA and some of the services offered.

Figure 2-1.2 SBA Website

Source: U.S. Small Business Administration, http://www.sba.gov.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How can you decide if being an entrepreneur is the right career for you? Your answers to the questions that follow will give you a better idea of whether or not you should consider owning your own business.

©Monkey Business Images, 2010/Used under license from Shutterstock.com

What traits do you have that could help you become a successful entrepreneur?

1. Are you self-motivated? If you can get going and do what you need to do without being told or reminded, you will make a good entrepreneur.
2. Do you like people? If you like people and can get along with your customers, you have a good chance of success.
3. Are you a leader? Entrepreneurs are able to get others to follow their lead. They are confident and persuasive.
4. Do you take responsibility? Entrepreneurs take charge and follow through.
5. Are you organized? Business owners must have a good plan before they get started. They line up their resources, fill in the gaps, and charge forward.
6. Do you work hard? To be a successful owner, you must set the pace by example. Business owners work many long, hard hours. They don't expect others to do what they themselves are unwilling to do.
7. Do you make decisions easily and quickly? Owners must take risks and be willing to accept the consequences. Decisions sometimes have to be made without complete information.
8. Are you trustworthy? Others must trust you and accept that you know what you are talking about. This means building trust and long-term relationships.
9. Are you persistent? Business owners stick with it, even when the going gets tough. They finish projects and forget about excuses.
10. Do you keep good records? Entrepreneurs must account for their costs and their revenues. They must pay taxes and understand about profitability and cost analysis. These things require complete and accurate records.

If you have a good business idea, you should start the process early. Get your thoughts and plans onto paper, get advice from those you trust, and work toward your dream of owning your own business. In putting your idea into writing, you will be starting your business plan. A *business plan* is a document that describes the steps that will be taken to open and operate a business. It should show that you are worthy of funding (loans) from government and private sources, such as banks and venture capitalists. Sample business plans can be found at the SBA website or at various other websites by conducting an online search using the keywords *business plans*.

CHECKPOINT ▸ ▸ ▸

Why would a person want to be an entrepreneur?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Are Employee Benefits?

Full-time workers usually have benefits provided by the employer. **Benefits** are forms of pay other than salary or wages. Paid vacation and holidays are examples of benefits. Some benefits are paid for by the company. For other benefits, such as health insurance, the worker may need to pay part or all of the cost.

benefits forms of pay other than salary or wages

A *cafeteria plan* is a benefit plan that allows workers to choose from a number of options. Workers may be able to save money by selecting only the options they need. Most plans include basic choices for health, life, and other insurance. Other options, such as a savings plan, may also be available.

Benefits increase the overall value a worker receives from a job. **Disposable income** refers to the money a person has available to spend or save after taxes have been paid. Money received from some benefits, such as a profit-sharing plan, can directly increase a worker's disposable income. Other benefits have the effect of indirectly increasing disposable income. For example, health insurance bought through a company plan may be cheaper than an individual policy. The money saved by joining the group plan is available to spend on other items.

disposable income money available to spend or save after taxes have been paid

Benefits are also important to workers for several other reasons:

- Workers are not taxed on most benefits. This means that workers receive something of value without paying tax as part of the cost.
- Some benefits allow workers to buy services at a cheaper price than they could otherwise. For example, group insurance costs much less than an individual policy. Paying a lower cost for insurance increases the worker's disposable income.
- Some benefits offered to workers may not be available to individuals, such as company retirement plans and stock options.
- Some benefits offered to workers may not be affordable at individual prices. For example, workers who have health problems might not be able to afford insurance at individual rates or may even be denied coverage at all.
- Some benefits help workers reach financial goals. For example, some people find it hard to save money. With company-sponsored savings plans, saving becomes easier because the money is automatically deducted from the worker's paycheck. Some savings plans have tax-savings features, and companies often match employees' contributions to the plan up to a certain amount.

PAY WITHOUT WORK

Pay without work refers to times when an employee who is not working will be paid. Paid vacations, holidays, and sick leave are examples of pay without work. Full-time and salaried employees usually get annual paid vacations. Typically, after the first year, an employee gets one to two weeks of vacation a year.

Most employers provide certain *paid holidays*. Examples of paid holidays are Thanksgiving Day, Christmas Day, and Labor Day. On those days, employees will be paid but will not have to work. Employees who do work on holidays may receive extra pay—typically two times the regular rate.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

sick leave paid time away from work due to illness

Many companies allow workers to take a certain number of sick days per year. **Sick leave** is paid time away from work due to illness. Some companies allow the use of sick leave to care for a sick child or other family member. Typically, an employee is allowed up to 10 paid days of sick leave per year. Some companies allow unused sick leave to accumulate. That means that workers can save sick leave not used in one year and have it available for use in another year in the case of extended illness.

personal leave paid time away from work for personal reasons

Some employers also offer personal leave. **Personal leave** is paid time away from work for personal reasons. The worker usually does not have to give a reason. Typically, two or three days a year are granted for personal leave. Unused personal leave is generally not carried forward to another year.

These and other pay-without-work benefits allow employees to rest, take care of personal business, plan family vacations and special events, and get away from work pressure and stress, all of which are part of a balanced and healthy life.

EDUCATIONAL BENEFITS

Some employers provide plans that will pay for, share the cost of, or reimburse (pay back) money spent on education. For example, some companies pay for the cost of classes or training related to the worker's job. This training can benefit both the company and the employee, who may be able to perform better using the skills learned. With additional education or training, the employee may also have improved chances of getting a promotion or a better job with the same or a different company. Some employer plans will even pay for classes taken to earn a college degree, which is a benefit of great value, now and in the future.

In a typical education plan, the employee will be repaid 100 percent of the cost of tuition and books if an A grade is received in the class. If the employee earns a B grade, 90 percent of the costs will be repaid. If the employee earns a C grade, 80 percent of the costs will be repaid. If the employee's grade is below a C, no costs will be repaid.

© Monkey Business Images, 2010/Used under license from Shutterstock.com

Why do some employers offer educational benefits?

PERKS

Providing high wages and good benefits, such as pay without work and education plans, is one way that companies motivate employees. Other types of benefits, called *perks*, have a different value. They provide emotional satisfaction or social status rather than money. Examples of perks are a prime parking space, an office with a view, an expense account, and a company car. Some of these benefits are not taxable, adding to their value. When perks are taxable, they are considered a part of an employee's basic compensation package.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

INSURANCE

Health insurance is an important benefit for many workers. The price paid for health insurance is called a *premium*. In the past, many employers paid the full premium for employees. The costs of health care have risen steadily over the past several years and are expected to continue increasing. Today, employees typically pay a portion or all of their insurance premiums through payroll deductions. Being able to participate in the company-offered group plan is a benefit in itself because group rates are typically much lower than those for individual policies and acceptance into the program is guaranteed. The premiums vary depending on the coverage provided. An employee with a spouse and children would pay more than a single employee. Dental or vision care insurance may also be available.

Group life insurance is often available at work. The premium may be paid by the employer or the employee. In some companies, the employer pays for a certain amount of life insurance, such as twice the employee's annual salary. The employee may be able to purchase additional coverage at the group rate. Life insurance paid for by the employee may be *portable*, which means the employee may be able to continue the policy after leaving the employer.

Disability insurance provides payments to replace income lost when illness or injury prevents the employee from working. It is an option for many employees. Coverage for short-term disability (up to two years) is often paid for by the employer. Long-term disability insurance typically covers periods longer than two years and up to retirement.

Workers' compensation is an insurance plan that employers are required by law to provide for employees. It pays medical and disability benefits to workers who are injured or contract diseases on the job. Benefits may also be paid to the worker's family if the worker is killed on the job.

RETIREMENT PLANS

Many companies offer 401(k) retirement plans. A **retirement plan** is an account into which employees contribute a portion of their earnings for their retirement. The employer may or may not make a matching contribution. This type of plan is tax-deferred, or pretax, meaning employees can avoid paying income tax on the money in the account until it is withdrawn. Contributions to the account are automatically deducted from the employee's paycheck.

retirement plan an account into which employees contribute a portion of their earnings for their retirement; employers may match these contributions

Some companies offer retirement accounts called *pension plans* that are paid entirely by the employer. Pension plans provide payments to retired workers. Typically, employees must work for the company for a certain number of years to qualify. The payment amounts vary depending on the number of years worked, the worker's salary, and other factors. This type of benefit is being phased out by most companies in favor of the 401(k) retirement plan.

PROFIT-SHARING PLANS

A **profit-sharing plan** allows employees to share in the profits of the business. The plan may pay a bonus of a specified percent of the

profit-sharing plan a benefit whereby employees may share in the profits of the business

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

employee's salary if the business meets or exceeds its financial goals. The bonus may be paid in cash, or it may be added to a retirement account. If paid in cash, it is taxable in the year received. If added to a retirement account, it is taxed when withdrawn by the employee. Profit-sharing plans help motivate employees to achieve company goals.

STOCK OPTION PLANS

Some companies allow employees to buy stock in the company at a reduced price. The purchase price of the stock may be deducted from the employee's pay. This is a convenient way to acquire stock, and it does not involve brokerage or trading fees.

HEALTH SPENDING ACCOUNTS

A health flexible spending account (often called a *Flex 125 plan*) allows employees to set aside money (pretax) to pay for qualified medical expenses. The plans are often set up by employers as an employee benefit. Deductions are made from the employee's pay to fund the account. The employee files claims for qualified expenses to be paid from the account. The major disadvantage of the Flex 125 plan is that, if the employee does not use the money in the account by the end of the year, he or she loses it (to the employer). Because the money cannot be carried forward to the next year, the employee must carefully estimate what the medical expenses will be each year.

A *health savings account* (*HSA*) can be used by employees who have high-deductible health insurance plans. High-deductible plans are becoming more popular because their premiums are lower. Employees can set aside money (pretax) in an HSA to pay for qualified medical expenses not covered by insurance. The employer may also contribute a monthly amount to the HSA. HSAs are usually managed by banks or investment companies. Money put into the accounts gain interest or earnings based on how the money is invested. Typically, medical expenses are paid using a debit card that accesses the HSA. Money in an HSA that is not used by the end of the year can be carried forward to the next year. When employees leave the job or retire, they can take their HSA with them and continue to use it for medical expenses.

OPTIONAL DEDUCTIONS

Most employers also allow their employees to have other amounts withheld from their paychecks. For example, employees may wish to donate money to a charity or to put money into self-managed savings or investment accounts. The employer withholds money from the paycheck (usually after taxes have been paid on it) and sends it to the designated source.

CHECKPOINT ▸ ▸ ▸

Why are benefits an important part of a compensation package?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. Forms of pay other than salary and wages

_____ 2. Paid time away from work for personal reasons

_____ 3. A benefit whereby employees may share in the profits of the business

_____ 4. The lowest pay rate allowed by law

_____ 5. A person who takes the risks of being self-employed and owning a business

_____ 6. Money that is available to spend or save after taxes have been paid

_____ 7. Paid time away from work due to illness

_____ 8. Pay received for hours worked above regular hours

_____ 9. A set fee or percentage of a sale paid instead of or in addition to salary or wages

a. benefits
b. commission
c. disposable income
d. entrepreneur
e. minimum wage
f. overtime pay
g. personal leave
h. profit-sharing plan
i. retirement plan
j. sick leave

CHECK YOUR UNDERSTANDING

10. Why are people often paid minimum wage when they start a new job?
11. What is overtime pay? How much is overtime pay compared to regular pay?
12. How is being paid a salary different from being paid hourly wages?
13. Give an example of a worker whose pay may include tips.
14. What are some advantages of self-employment? What are some disadvantages?
15. Why are employee benefits important to employees?
16. Give three examples of pay without work.
17. Why is educational reimbursement a valuable benefit for employees?
18. Why are employees at many companies expected to help pay for the cost of health insurance?
19. Describe two types of retirement plans offered by companies.
20. How does a health flexible spending (Flex 125) account benefit employees?
21. Why are high-deductible health plans and HSAs popular?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

22. Minimum wage started at 25 cents per hour in 1938 and has risen steadily over the years. Still, workers earning minimum wage have difficulty paying their living expenses. How can people working for minimum wage stretch their earnings so that they can pay their bills? What can they do to earn more than minimum wage?
23. Some jobs, such as real estate sales, are typically commission-only (with no base salary or wages). If no sale is made, no income is earned. How can these types of workers prepare themselves to be able to pay their bills during times when there are no sales?
24. Being an entrepreneur is the American dream—owning your own business and answering only to yourself. Not everyone is suited to be an entrepreneur. Describe the traits of persons who would do well owning their own business. What kinds of hard and soft skills are necessary for small business owners?
25. Benefits are a very important part of most workers' compensation plans. Make a list of the three benefits that would be most important to you and explain why each is so important to your financial security.
26. Many companies today are passing along the cost of rapidly rising health care costs to their employees. What is the benefit of doing this (to the employer and to the employee)? What are the disadvantages (to the employer and to the employee)?

EXTEND YOUR LEARNING

27. Work with a classmate to complete this activity. Select a career in which the worker earns a salary, such as teacher, manager, or accountant. Do some online and library research or interview a worker in this profession to answer the following questions:
    a. How many hours a week does a beginning-level employee work?
    b. What is the beginning pay level?
    c. What kinds of benefits currently are being offered to people in this profession?
    d. Would you like to do this kind of work? Why or why not?

Point Your Browser

www.cengage.com/school/pfinance/pfl

28. Go to the Personal Financial Literacy website found at **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 2. Open and print the data file *CH02 Benefits*. A cafeteria plan of benefit choices, along with their dollar value, is shown in the document. Assume that your salary is $1,600 per month and that your total benefits package (including salary) can total up to $2,000. Review and evaluate the list of benefits offered. Decide which ones would be of the most value to you. You can go over $2,000 in total pay and benefits costs only if you wish to have any costs over $2,000 deducted from your paycheck. Indicate your choices on the form.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-2 Unearned Income and Payments

GOALS

- Name private and governmental sources of unearned income.
- List the types of taxes levied against individuals and businesses.
- Discuss the benefits of paying taxes, both direct and indirect.

KEY TERMS

- unearned income, p. 51
- interest, p. 51
- dividends, p. 51
- transfer payments, p. 52
- in-cash payments, p. 54
- in-kind payments, p. 54
- use taxes, p. 55
- excise taxes, p. 55
- sales taxes, p. 55
- property taxes, p. 56
- public goods, p. 58

What Is Unearned Income?

Unearned income is money received from sources other than working in a job, either for yourself or for someone else. There are several sources of unearned income for individuals.

unearned income money received from sources other than working

PRIVATE SOURCES

One form of unearned income is **interest**, which is money earned on savings accounts and other funds. It is unearned because the owner does not work to receive it. A bank will pay you interest on funds you deposit into a savings account with the bank. The bank will use the deposited funds to make loans and investments and will pay you interest for the use of your money. When you put your money aside in a certificate of deposit (CD), it also accumulates interest. You can also loan money to the government by purchasing U.S. Savings Bonds. Once again, you will receive interest on this money.

interest money earned on savings accounts and other funds

Another form of unearned income is **dividends**, which are a portion of a corporation's profits distributed to stockholders. *Stockholders* are the people who buy stocks in a corporation. A *cash dividend* payment is money shared with stockholders when a corporation makes profits. Dividends may also be in the form of stock, known as *stock dividends*. While you do not receive actual cash, the added shares of stock increase your wealth.

dividends a portion of a corporation's profits distributed to stockholders

Retired people may receive pension payments or other forms of retirement benefits from employer pension funds or individual retirement accounts. Some people may receive winnings or prizes from the lottery or other contests. These are other examples of unearned income. That is, you are receiving income from sources other than working.

The Internal Revenue Service (IRS) lists some types of income as variable income. *Variable income* refers to money received from some type of activity other than from working under the direct control of another person or company. The income may be earned or unearned, depending on the situation in which it is received. *Royalties* (payments for the use of copyrighted material, such as books or songs) and rent are examples of variable income. Variable income is often unpredictable from year to year and depends on general economic conditions. Figure 2-2.1 shows different types of income as listed by the IRS.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-2.1 Types of Income

Earned Income	Unearned Income	Variable Income
Salaries and wages	Interest	Business profits
Tips	Dividends	Rents
Commissions	Capital gains	Royalties
Bonuses	Gambling winnings	Farm income
Professional fees	Alimony	
	Social security benefits	
	Pensions	
	Annuities	
	Unemployment compensation	

Like earned income, most forms of unearned income and variable income are fully taxable. However, the tax rates may be lower than income tax rates on earned income. Because this income is not earned, it is not subject to employment taxes. Some forms of variable income are subject to employment taxes (business profits and farm income) while other forms (rents and royalties) are not subject to employment taxes.

GOVERNMENT TRANSFER PAYMENTS

transfer payments money and benefits received from local, state, or federal governments

Money and benefits received from local, state, or federal governments are called **transfer payments**. Transfer payments are made from many different programs. They increase the disposable income of those who receive them. Examples of transfer payments provided from state and federal governments are shown in Figure 2-2.2.

Figure 2-2.2 Transfer Payments

Type of Benefit:	Paid to:
Temporary assistance for needy families (TANF)	Needy families with children; varies by state
Medicaid	Low-income families
Veterans' benefits	Veterans and their families
Supplemental security income (SSI)	Low-income elderly and disabled
State-provided medical plans	Low-income residents
Social security	Retirees, disabled workers, dependents
Medicare	Retired people with social security
Unemployment compensation	Laid-off workers; varies by state
Workers' compensation	Workers injured on the job

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

CRITICAL LISTENING

Critical listening involves evaluating the information you hear. The goal is to consider only the important or relevant information. Unneeded, untrue, or conflicting information is unnecessary. When you listen critically, you are able to make good decisions based on what is accurate and useful.

For example, pretend you are buying a used car. The seller is telling you about the car and its features. He tells you that the car runs great and will run for years to come. It is the best car he ever had. These statements are not useful for making a decision about whether to buy the car. Next, the seller tells you that the car was serviced regularly (and shows you the receipts), has traveled 34,000 miles, and was kept in a garage every night. Using this information can help you make a good decision.

Try It Out

1. Pair up with another student. Take turns telling each other about an experience you recently had completing a project, such as baking a cake or completing a science experiment. Detail all the steps you took from the time you started until you finished. Listen carefully to the speaker and summarize aloud in one sentence, ten words or less, what the person accomplished.
2. How can critical listening help you make good decisions?

Some transfer payments provide income to retirees. Although they have stopped working, their needs continue. Other government transfer programs provide benefits to help low-income families with medical needs or living expenses. For example, Medicaid is a program of medical aid designed for those unable to afford medical service.

In the United States, transfer payments are a "safety net" so that workers who lose their jobs, become injured, or fall victim to natural disaster will have a place to turn. Many of these benefits (other than social security and Medicare) are not intended as handouts but rather as "handups." This means they are intended as temporary help to get people back on their feet again. With social security and Medicare, which are often referred to as *entitlement programs*, retirees have paid into the programs through payroll tax deductions during their working years.

©Delmas Lehman, 2010/Used under license from Shutterstock.com

How do government transfer payments help victims of natural disasters?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

SOCIAL SECURITY BENEFITS

Most workers in the United States pay into the social security fund. A social security number is assigned to each person's account. Payments are made into the account through payroll deductions. These payments are matched by employers. Based on the amount paid into the account and other factors, the worker will receive monthly benefit checks when he or she retires.

Each year while paying into the fund, workers should receive a social security statement. The statement allows workers to see that earnings are being posted properly to their accounts. If you are a worker and do not receive a statement, you should request one. A statement can be requested at a local Social Security Office or at the Social Security Administration's website (www.ssa.gov).

Think Critically

1. Social security was created by law in 1938. Research the Social Security Act on the Internet. Why do you think such a program was needed? (Hint: The Great Depression started in 1929.)
2. Social security was never intended to meet the full retirement needs of someone unable to work. Rather, it is intended as supplemental income. What do you need to do to avoid depending on social security as your only form of retirement income?

In-Cash Payments

in-cash payments money in the form of check, debit card, or other direct payment given to a person needing assistance

In-cash payments are money in the form of a check, debit card, or other direct payment given to a person needing assistance. For example, after Hurricane Katrina, flood victims were given debit cards worth $1,000. They used the cards to buy food, clothing, and other items. Social security payments, unemployment benefits, and workers' compensation payments are also examples of in-cash payments. People receive checks or have direct deposits made to their checking accounts.

To receive in-cash transfer payments from the federal or state government, you must fill out an application and show need. In most cases, your need must be verified by the government agency. People who try to hide income or assets are committing fraud and may face criminal charges.

In-Kind Payments

in-kind payments payments made indirectly on a person's behalf or in a form other than money

In-kind payments are made indirectly on a person's behalf or paid in a form other than money to those in need. Examples include food stamps, rent subsidies, and vouchers that can be exchanged for goods and services.

The U.S. federal government and state governments make in-kind transfer payments. For example, Medicaid is a program in which payments are made to medical providers on behalf of those unable to afford medical services. Many people age 65 or older qualify for Medicare hospital insurance based on their own or their spouse's work record. Some people under age 65 who are disabled may also qualify.

CHECKPOINT ▸ ▸ ▸

How are in-kind payments different from in-cash payments?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Types of Taxes Do You Pay?

Taxes are collected from many sources. Taxes are based on consumption, income, and wealth. They may be assessed by the federal and state government, and in some cases, by county, city, and local governments as well. Some of these taxes are *direct taxes*, which means consumers pay them directly to the government. Other taxes are *indirect*, which means they are charged on goods or services bought by the consumer. In such cases, the selling business sends the collected taxes to the government.

use taxes taxes based on the use of goods and services provided by the government

TAXES BASED ON CONSUMPTION

The first type of tax is based on what consumers use or buy. Only those who purchase certain goods and services are charged these taxes. These forms of tax are considered indirect—you may not pay it directly to the government, but it is collected from you and the business sends it later. Some items, such as gasoline, may be subject to more than one type of consumption tax.

©Lisa F. Young, 2010/Used under license from Shutterstock.com

Why do states levy gasoline taxes?

Use Taxes

Use taxes are paid by people who use certain goods or services provided by the government. Those who do not use the good or service do not pay the tax. For example, people who visit a state or national park may be charged a use tax. This money is used to help pay for operation of the park. Drivers may have to pay a toll to be able to cross a bridge. This use tax helps to pay for the bridge maintenance and operation. A *gasoline tax* is another type of use tax that helps to keep the roads and highways repaired.

Excise Taxes

Another type of consumption tax is the excise tax. **Excise taxes** are charged on the purchase of specific goods, such as gasoline, cigarettes, and alcoholic beverages. They are also charged on services, such as phone service, utilities, and garbage collection. Excise taxes are usually included in the price of the product or service. They help pay for government goods and services. An excise tax on a product that is not considered essential for a normal standard of living, such as an expensive car or yacht, is called a *luxury tax*.

excise taxes taxes charged on the purchase of specific goods and services

sales taxes taxes levied on consumer purchases of goods and services

Sales Taxes

Sales taxes are charged in most states. **Sales taxes** are added to the purchase price of consumer goods and services. The sales tax is a percentage of the cost of the purchase price. If you purchase a refrigerator, clothing, or other goods subject to sales tax, the tax is added to the cost of your purchase. The retailer will collect the sales tax from the consumer and send it to the state's department of revenue. Typically, most states that have sales taxes do not tax medical services, prescriptions, and food that you prepare at home. If you eat out at a restaurant, however, the sales tax will be added to your purchase.

Sales taxes are known as *regressive taxes* because they take a larger percentage of income from lower-income people than from higher-income

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Banana Stock/Jupiter Images

How do sales taxes affect consumers' income?

people. Because the price of a product is the same regardless of income level, the sales tax paid is also the same and is a bigger burden on lower-income people.

TAXES BASED ON INCOME

The federal government requires *income taxes* to be paid on earned and unearned income. An income tax is a direct tax paid directly to the government. It is called a *progressive tax* because the more you earn, the more you pay in tax. For example, someone with low income may pay 15 percent of their income as taxes while someone with higher income may pay 28 percent.

Businesses also pay taxes based on income. In some states, they also pay business license taxes, occupancy taxes, and various other fees to help pay for public transportation and other services. Generally, these taxes are based on income generated by the business or on the size of the business.

Most states also levy a tax based on income, and cities and counties often do too. The state and local income taxes are in addition to the federal income tax you pay. You will learn more about individual income taxes later in the chapter.

TAXES BASED ON WEALTH

property taxes wealth taxes based on the assessed value of owned real estate

Wealth taxes are another form of direct tax. They are levied against the value of the property and assets that you own. **Property taxes** are paid by those who own real estate. The tax is based on the property's *assessed value*, which is determined by the county or other taxing authority. Assessed value may not be the same as *market value*, which is the highest price for which the property would sell to a willing buyer.

In some states, businesses pay a *business personal property tax*. This tax is levied against property other than real estate, such as equipment, that is used by the business to generate income.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-2.3 Partial List of U.S. Taxes

Alternative minimum tax	State and local income tax
Capital gains tax	Luxury tax
Corporate income tax	Property tax
U.S. estate tax	Hotel occupancy tax
U.S. excise tax	Rental car tax
Federal income tax	Recreational vehicle tax
Federal unemployment tax (FUTA)	Road usage tax (commercial trucks)
FICA (social security and Medicare tax)	Sales tax
Gasoline tax (federal and state)	State unemployment tax (SUTA)
Gift tax	Tariffs
Vehicle sales tax	Workers compensation tax
Cell phone tax (911 and other)	IRS penalties
Use tax	

Another type of wealth tax is the federal *estate tax* or the state *inheritance tax*. These taxes are levied against the estate of a person who has died or the person who inherits the deceased's money or property. In most cases, the estate must exceed $3.5 million to be subject to the tax. The estate tax laws could be reformed. Find out about recent changes by searching online.

In addition, a *gift tax* is levied by the federal government. It is paid by those who give more than $13,000 to any person within a tax year. This amount is adjusted periodically.

The U.S. government collects money through a number of taxes. Figure 2-2.3 is a partial list of those taxes.

CHECKPOINT

How are consumption taxes different from income and property taxes?

How Do You Benefit from Paying Taxes?

Paying taxes reduces the disposable income of an individual. The more taxes a person pays, the less money he or she has available to save or spend. When people have less money to spend, the economy may be affected. When people spend less on goods and services, businesses have lower sales. Lower sales may lead to lower profits. Workers may have to be laid off or dismissed from their jobs. Charitable groups may receive less money from donations. Having less money means these groups are unable to help more people in need. These are all disadvantages of paying taxes, but there are some benefits.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Aleksey Fursov, 2010/Used under license from Shutterstock.com

How do you use public goods provided by taxes collected?

DIRECT BENEFITS

Paying taxes can benefit the person making the payments and others who do not make payments. For example, social security tax provides a system of old-age, survivors, and disability insurance. Workers pay social security tax during their working years. When they retire, workers receive payments from the social security fund. This is an example of a direct benefit from paying taxes.

Taxes also provide overall benefits. **Public goods** are the goods and services provided by government. Examples include national defense, public education, police protection, national parks, and roads and highways. You benefit from the security provided by our armed forces. Taxes collected pay for military members' wages and benefits and the equipment needed to protect us. Police protection is available when you need it. Because there are various policing agencies enforcing the laws, you are able to enjoy relative peace and security.

public goods government-provided goods and services paid for by taxes

Public goods have three unique qualities:

- Everyone benefits from them (they raise the overall standard of living in a country).
- No one can be excluded from the benefits.
- People do not benefit in direct proportion to taxes paid; those who benefit the most often pay less.

INDIRECT BENEFITS

Even if you do not benefit directly, you benefit indireclty when others receive government assistance. For example, government transfer payments are funded with taxes. Because others receive a free vaccination, you are protected from the spread of illness. Providing public education to citizens produces a higher-quality workforce, giving you the benefit of better products and services.

Most individuals could not afford to pay for the government services they receive. These goods and services increase our overall standard of living. Not everyone benefits directly from every type of tax. For example, some people may never visit a state or national park. However, everyone benefits from some government services.

You must consider that taxes paid benefit society as a whole. Without the benefit of the goods and services provided because of taxes, citizens would be worse off.

CHECKPOINT ▸ ▸ ▸

How are the direct benefits of paying taxes different from the indirect benefits?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Money and benefits received from local, state, or federal governments

____ 2. Taxes charged on the purchase of specific goods and services

____ 3. Wealth taxes based on the value of owned real estate

____ 4. Money received from sources other than working

____ 5. Taxes added to the purchase price of goods and services

____ 6. Payments made indirectly or in a form other than money

____ 7. Taxes based on the use of goods and services, such as parks

____ 8. A portion of a corporation's profits shared with stockholders

____ 9. Money in the form of a check, debit card, or other direct payment to a person needing assistance

a. dividends
b. excise taxes
c. in-cash payments
d. in-kind payments
e. interest
f. property taxes
g. public goods
h. sales taxes
i. transfer payments
j. unearned income
k. use taxes

CHECK YOUR UNDERSTANDING

10. How is unearned income different from earned income?
11. List three private sources of unearned income.
12. How are cash dividends different from stock dividends?
13. What is variable income? Give two examples.
14. What are government transfer payments? How are they funded?
15. How are social security and Medicare different from other forms of government transfer payments?
16. What is a use tax? Give two examples.
17. What is an excise tax? Give two examples.
18. What is the difference between a direct tax and an indirect tax?
19. How can raising (or lowering) taxes affect the economy?
20. Give two examples of direct benefits you receive from paying taxes.
21. What are three characteristics of public goods?
22. Explain how you benefit indirectly from paying taxes.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

23. When people retire, they receive social security payments. If their total income (earned and unearned) exceeds $25,000 (or $32,000 for a married couple), half of their social security benefits are taxable. To many people, this is like a "tax on a tax." In other words, they already paid taxes on income when they were working, including social security taxes. Now at retirement, when they receive it back, they are taxed again. What is the purpose of such a tax?
24. Depending on government assistance can be a trap. When needy people receive government benefits, they are often penalized. For example, if they have any earnings, it is deducted from their transfer payments. Thus, they have no incentive to work. How might this situation be remedied?
25. In-cash payments provide more flexibility than in-kind payments. With in-kind payments, the recipient is limited in how they may be used. For example, with food stamps, recipients are limited in what they can buy (certain items cannot be purchased with food stamps) and where they can buy (not all stores accept the stamps or vouchers for payment). Why do governments use in-kind payments rather than in-cash payments for those who are in need?
26. Some people complain because they feel that they pay taxes but receive little or no benefits. For example, a retired couple must still pay property taxes that support local schools even though they have no children in school. People who are wealthy pay taxes but do not receive Medicaid benefits. Explain how these people benefit *indirectly* from these government services.
27. In comparing and contrasting consumption taxes, income taxes, and wealth taxes, which one is often considered to be the most "fair" tax? Why?

EXTEND YOUR LEARNING

28. Many different types of taxes are paid by people in your area. Work in a group with two or three classmates to learn about the kinds of taxes being paid.
    a. Interview adult relatives or friends who work to learn what types of taxes are deducted from their pay. Call or visit local government offices and/or search the Internet to learn about other taxes paid in your area. Look at receipts for purchased goods to see if taxes were charged. You may also find taxes listed on bills for phone, cable, utilities, and so on.
    b. List all the types of taxes you found. Organize your list into categories: sales, excise, income, property, and so on.
    c. Compare your list to those of other groups in your class. Did you miss any? How many total types of taxes were listed by the entire class? What conclusions can you draw?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-3 Taxes and Other Deductions

GOALS

- List the required and optional deductions from gross pay.
- Explain the contents of commonly used federal tax forms.

KEY TERMS

- gross pay, p. 61
- net pay, p. 61
- exemption, p. 61
- dependent, p. 61
- social security tax, p. 62
- Medicare tax, p. 63
- workers' compensation, p. 63
- Form W-2, p. 65
- Form 1040EZ, p. 65

What Are Paycheck Deductions?

As an employee, you earn wages or a salary, but you don't get to spend all of it. Your pay is reduced by required and optional deductions. Certain deductions, such as taxes, lower your *disposable income* (how much you have to spend on your needs and wants). When you pay fewer taxes, your disposable income rises.

Photodisc/Getty Images

Why don't you get to spend all of the wages you earn?

REQUIRED DEDUCTIONS

Employees are required to have money withheld from their paychecks for income tax, social security tax, and Medicare tax. Other taxes and deductions may also be withheld. Many states have a state income tax. Some counties and cities also have an income tax.

Taxes and deductions for other items are subtracted from the worker's gross pay to calculate net pay. **Gross pay** is your total salary or wages earned during the pay period. When deductions are subtracted, the result is **net pay**, or the amount of your paycheck. Net pay is also referred to as *take-home pay*. The paycheck stub in Figure 2-3.1 shows the gross earnings, deductions, and net pay of Gloria Perez.

Income Tax Withholding

Federal and state income taxes are withheld according to the amount of income and the number of exemptions claimed on *Form W-4*, as shown in Figure 2-3.2. An **exemption** is a person you claim on your tax return as a dependent. The Internal Revenue Service (IRS) provides details of how a person qualifies as a dependent. A **dependent** is a person who depends on you for more than half of his or her support. Minor children are claimed as dependents on their parents' tax return. The more exemptions you claim, the less tax is withheld. Everyone is allowed to claim one exemption for themselves (unless claimed as an exemption by someone else). People who are married or have children can claim more exemptions. Federal income tax withholding rates can be viewed at the Internal Revenue Service website (www.irs.gov).

gross pay total salary or wages earned during the pay period

net pay the amount of your paycheck after deductions

exemption a person claimed as a dependent on a tax return

dependent a person who depends on you for more than half of his or her support

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-3.1 Paycheck Stub

EMPLOYEE NAME	EMPLOYEE ID	PAY PERIOD	CHECK DATE	CHECK NO.
Gloria M. Perez	482975	2/1/20-- thru 2/14/20--	2/21/20--	A001161
EARNINGS	HOURS	RATE	THIS PERIOD	YEAR-TO-DATE
Regular	80	$13.00	$1,040.00	$3,120.00
Overtime				
		TAXES		
		Federal Income Tax	$82.19	$246.57
		Social Security Tax	64.48	193.44
		Medicare Tax	15.08	45.24
		State Income Tax	34.27	102.81
		City Income Tax	3.14	9.42
		SUBTOTAL	$199.16	$597.48
		DEDUCTIONS		
		Health Insurance	$150.00	$450.00
		Life Insurance	12.00	36.00
		401(k) Plan	52.00	156.00
		Dental Insurance	10.00	30.00
		SUBTOTAL	$224.00	$672.00
NET PAY			$616.84	$1,850.52

Social Security Tax

social security tax a withholding tax to provide old-age, survivors, and disability insurance

Social security tax, which is withheld for the federal government, provides a system of old-age, survivors, and disability insurance. The rate of the tax and the amount of income that is taxable change each year. As of 2010, the rate is 6.2 percent on earnings up to $106,800. The maximum earnings is adjusted each year for the cost of living. Money withheld for this tax is paid into an account under your name and social security number. The employer must contribute the same amount to your account. People who are self-employed must pay 12.4 percent on earnings up to $106,800.

Figure 2-3.2 Form W-4

Cut here and give Form W-4 to your employer. Keep the top part for your records.

Form **W-4**
Department of the Treasury
Internal Revenue Service

Employee's Withholding Allowance Certificate

► **Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.**

OMB No. 1545-0074
20—

1 Type or print your first name and middle initial: Gloria M.
Last name: Perez
2 Your social security number: 000 22 2105

Home address (number and street or rural route): 123 Maple Street
City or town, state, and ZIP code: Monticello, KY 42633-0123

3 ☑ Single ☐ Married ☐ Married, but withhold at higher Single rate.
Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.

4 **If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card.** ► ☐

5 Total number of allowances you are claiming (from line **H** above **or** from the applicable worksheet on page 2) 5 1

6 Additional amount, if any, you want withheld from each paycheck . . . . . 6 $

7 I claim exemption from withholding for 20—, and I certify that I meet **both** of the following conditions for exemption.
- Last year I had a right to a refund of **all** federal income tax withheld because I had **no** tax liability **and**
- This year I expect a refund of **all** federal income tax withheld because I expect to have **no** tax liability.

If you meet both conditions, write "Exempt" here . . . . . ► 7

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature
(Form is not valid unless you sign it.) ► Gloria M. Perez
Date ► 5/20/20—

8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)
9 Office code (optional)
10 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 10220Q Form **W-4** (20—)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-3.3 Form I-9

OMB No. 1615-0047; Expires 08/31/12

Department of Homeland Security
U.S. Citizenship and Immigration Services

Form I-9, Employment Eligibility Verification

Read instructions carefully before completing this form. The instructions must be available during completion of this form.

ANTI-DISCRIMINATION NOTICE: It is illegal to discriminate against work-authorized individuals. Employers CANNOT specify which document(s) they will accept from an employee. The refusal to hire an individual because the documents have a future expiration date may also constitute illegal discrimination.

Section 1. Employee Information and Verification *(To be completed and signed by employee at the time employment begins.)*

Print Name: Last	First	Middle Initial	Maiden Name
Perez	Gloria	M	Valdez
Address *(Street Name and Number)*		Apt. #	Date of Birth *(month/day/year)*
123 Maple Street			3/20/1983
City	State	Zip Code	Social Security #
Monticello	KY	42633	000-22-2105

I am aware that federal law provides for imprisonment and/or fines for false statements or use of false documents in connection with the completion of this form.

I attest, under penalty of perjury, that I am (check one of the following):

- [X] A citizen of the United States
- [ ] A noncitizen national of the United States (see instructions)
- [ ] A lawful permanent resident (Alien #) _____
- [ ] An alien authorized to work (Alien # or Admission #) _____ until (expiration date, if applicable - *month/day/year*)

Employee's Signature Gloria M. Perez Date *(month/day/year)* May 20, 20—

Employers are required to verify that workers are eligible to work in the United States. When a worker begins a job, the worker is required to complete Section 1 of *Form I-9*, Employment Eligibility Verification. Section 1 of the form is shown in Figure 2-3.3. The employee must enter a name, an address, and a social security number. The social security number recorded on this form is used to report social security taxes for the employee. The form also shows whether the employee is a citizen of the United States, a lawful permanent resident, or an alien who is authorized to work. The employer must verify the information by looking at certain documents, such as a U.S. passport, driver's license, and social security card.

Medicare Tax

Medicare tax is withheld for the federal government to pay for medical care for retired persons age 65 and older who receive social security benefits. As of 2010, workers pay 1.45 percent on *all* earnings for this tax. The employer must contribute the same amount to your account. People who are self-employed pay 2.9 percent on their earnings.

Medicare tax a tax that pays for medical care for retired persons

Social security and Medicare taxes combined are also known as *FICA tax*, because they were created by the Federal Insurance Contribution Act of 1938.

Workers' Compensation Insurance

Workers' compensation is an insurance plan that pays medical and disability benefits to employees who are injured or contract diseases on the job. Benefits may be paid to the employee's family if the employee is killed on the job. The amount of benefits an employee or his

workers' compensation an insurance plan that pays medical and disability benefits to workers injured on the job

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

WORKPLACE SAFETY

All workers are entitled, by law, to a safe place to work. This includes safe working methods and safety training. Workers' compensation premiums charged to a company are based, in part, on its safety record. Having a safe workplace and reducing the number of accidents or injuries benefits both workers and the company.

Safety begins with good work attitudes. Safety is part of everyone's job. All workers must understand safety needs and make safety a priority. Most work-related accidents, injuries, and illnesses are related to the following factors:

- carelessness of workers
- failure to use safety equipment
- lack of awareness of dangers
- not knowing how to avoid and reduce risks
- lack of a practiced and workable emergency plan

An *emergency plan* is a vital part of safety. An effective emergency plan provides for the safety of workers, employees, visitors, and others. Following an emergency plan helps prevent injuries in times of danger. A good emergency plan has the following parts:

- detailed steps to follow in the event of an emergency
- a list of who is responsible for each activity
- a list of who has backup roles
- a second plan in case one course of action fails
- a data backup system
- a process to communicate status
- practice drills so that everyone will know what to do in a real emergency

Emergency plans should be in writing and shared with everyone. If special training is required, it should be completed and practiced regularly.

Think Critically

1. What are the parts of a good emergency plan? Have you ever been a part of an emergency plan, such as practicing a fire drill?
2. Many families have emergency plans for their households as well. If you were designing an emergency safety plan for your family, what would you include?

family receives is based on the employee's earnings and work history. The laws that cover workers' compensation vary by state. In some states, the entire cost of the insurance is paid by the employer. In other states, the worker must also pay some fees related to workers' compensation. In these states, the fees are deducted from the workers' paychecks.

OPTIONAL DEDUCTIONS

Employees may have optional deductions made from their pay. Full-time workers usually have benefits provided by the employer. Employees may share in the cost of some benefits, such as health insurance. Workers may have money deducted from their pay for the following items:

- health insurance
- life insurance
- disability insurance
- dental insurance
- vision insurance
- flex 125 plan
- long-term care insurance
- savings plan
- retirement plan
- HSA
- stock purchase plan
- charitable donations

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

How is net pay calculated?

What Tax Forms Must Be Filed?

If you are a U.S. citizen or resident, whether you must file a federal income tax return depends upon your gross income, your filing status, your age, and whether you are a dependent. After taxes are filed the first time, the IRS usually sends paper forms to use in filing each year. Forms can also be accessed online at the IRS website. Users can download, save, and print tax forms needed for filing federal tax returns. Filing your tax return begins with receiving Form W-2.

FORM W-2

Form W-2 is used to report the taxable income a worker received during the calendar year. Employers are required to send workers a W-2 for the calendar year (January 1 through December 31) by the following January 31. A sample Form W-2 is shown in Figure 2-3.4. The information on the form is sent to the federal, state, and local governments as well as to the worker. Multiple copies are provided for the worker to attach to tax forms and to keep on file.

Form W-2 a form used to report taxable income a worker received during the calendar year

Note that the amount shown in box 1 (Wages, tips, other compensation) and in box 16 (State wages, tips, etc.) is $25,688.00. This figure is the amount of gross pay ($27,040.00 as reported in boxes 3, 5, and 18) less the money paid into a 401(k) plan. Money paid into a 401(k) plan is not subject to federal income taxes until it is withdrawn, usually during retirement. Some states, such as Kentucky in this example, also defer taxes on money paid into a 401(k) plan.

FORM 1040EZ

Several different forms can be used to file a federal tax return. The form that should be used depends on the type of income and deductions claimed. **Form 1040EZ**, shown in Figure 2-3.5 on page 67, is a short tax return form designed for use by single and joint filers with no dependents or itemized deductions. It can be completed using information found on the filer's Form W-2 and tax tables provided by the IRS. Refer to Figure 2-3.5 as you read the following points about Form 1040EZ. Note that this form is for 2009. The form for the current year may differ somewhat but will contain similar information.

Form 1040EZ the short tax return form designed for single and joint filers with no dependents or itemized deductions

- The filer's name, address, and social security number are entered in the boxes in the Label section near the top of the form. For a joint return, the spouse's name and social security number would also be included.
- In the Income section (lines 1 through 6), line 1 provides space to enter wages, salaries, and tips. Taxable interest, such as interest earned on a savings account, of $1,500 or less can be entered on line 2.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-3.4 Form W-2

	a Employee's social security number 000 22 2105	OMB No. 1545-0008	Safe, accurate, FAST! Use IRS e-file	Visit the IRS website at www.irs.gov/efile
b Employer identification number (EIN) 00-000000		1 Wages, tips, other compensation $25,688.00		2 Federal income tax withheld $2,136.94
c Employer's name, address, and ZIP code ABC Company 781 Weston Street Monticello, KY 42633-0781		3 Social security wages $27,040.00		4 Social security tax withheld $1,676.48
		5 Medicare wages and tips $27,040.00		6 Medicare tax withheld $392.08
		7 Social security tips		8 Allocated tips
d Control number		9 Advance EIC payment		10 Dependent care benefits
e Employee's first name and initial Last name Suff. Gloria M. Perez 123 Maple Street Monticello, KY 42633-0123		11 Nonqualified plans		12a See instructions for box 12 Code D $1,352.00
		13 Statutory employee ☐ Retirement plan ☒ Third-party sick pay ☐		12b Code
		14 Other		12c Code
f Employee's address and ZIP code				12d Code

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
KY	00000	$25,688.00	$891.02	$27,040.00	$81.64	Mont.

Form **W-2** **Wage and Tax Statement** 20— Department of the Treasury—Internal Revenue Service

Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

- Line 3 is for unemployment payments received in excess of $2,400.
- Line 4 is for adjusted gross income. This amount is the total of lines 1, 2, and 3.
- Line 5 shows the amount that can be deducted from adjusted gross income if you are not claimed on another tax return. As indicated on the tax form, you can enter $9,350 if you are single or $18,700 if married filing jointly.
- Line 6 should show the amount of adjusted gross income (line 4) minus the standard deduction (line 5) if the amount on line 4 is larger than the amount on line 5. This amount is the taxable income. Line 6 should have a 0 (zero) if the amount on line 5 is larger than the amount on line 4. This means you have no taxable income.
- Line 7 is the amount of federal income tax withheld. This number comes from a Form W-2 or a Form 1099.
- Line 8 is a special credit for 2009 (this may not appear on future returns). It was a tax refund in 2009 as a part of the Economic Recovery Act.
- Line 9a is for an earned income credit (EIC). This is a credit for certain low-income people who work. If the credit exceeds the amount of taxes owed, the tax filer will get a refund. A separate worksheet can be completed by those who think they may qualify for an EIC. Line 9b is for nontaxable combat pay.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 2-3.5 Form 1040EZ

Department of the Treasury—Internal Revenue Service

Form 1040EZ

Income Tax Return for Single and Joint Filers With No Dependents (99) **2009**

OMB No. 1545-0074

Label (See page 9.) **Use the IRS label.** Otherwise, please print or type.

LABEL HERE

Your first name and initial	Last name	Your social security number
Gloria M.	Perez	000-22-2105
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see page 9.	Apt. no.	▲ You **must** enter your SSN(s) above. ▲
123 Maple Street		
City, town or post office, state, and ZIP code. If you have a foreign address, see page 9.		Checking a box below will not change your tax or refund.
Monticello, KY 42633-0123		

Presidential Election Campaign (see page 9) ▶ Check here if you, or your spouse if a joint return, want $3 to go to this fund . . ▶ ☐ You ☐ Spouse

Income

Attach Form(s) W-2 here. Enclose, but do not attach, any payment.

1	Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	25,688	00
2	Taxable interest. If the total is over $1,500, you cannot use Form 1040EZ.	2		
3	Unemployment compensation in excess of $2,400 per recipient and Alaska Permanent Fund dividends (see page 11).	3		
4	Add lines 1, 2, and 3. This is your **adjusted gross income.**	4	25,688	00
5	If someone can claim you (or your spouse if a joint return) as a dependent, check the applicable box(es) below and enter the amount from the worksheet on back. ☐ You ☐ Spouse If no one can claim you (or your spouse if a joint return), enter $9,350 if **single;** $18,700 if **married filing jointly.** See back for explanation.	5	9,350	00
6	Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your **taxable income.** ▶	6	16,338	00

You may benefit from filing Form 1040A or 1040. See *Before You Begin* on page 4.

Payments, Credits, and Tax

7	Federal income tax withheld from Form(s) W-2 and 1099.	7	2,136	94
8	Making work pay credit (see worksheet on back).	8		
9a	**Earned income credit (EIC)** (see page 13).	9a		
b	Nontaxable combat pay election. 9b			
10	Add lines 7, 8, and 9a. These are your **total payments and credits.** ▶	10	2,136	94
11	**Tax.** Use the amount on **line 6 above** to find your tax in the tax table on pages 27 through 35 of the instructions. Then, enter the tax from the table on this line.	11	2,031	00

Refund

Have it directly deposited! See page 18 and fill in 12b, 12c, and 12d or Form 8888.

12a	If line 10 is larger than line 11, subtract line 11 from line 10. This is your **refund.** If Form 8888 is attached, check here ▶ ☐	12a	105	94
▶ b	Routing number	▶ c Type: ☐ Checking ☐ Savings		
▶ d	Account number			

Amount you owe

13	If line 11 is larger than line 10, subtract line 10 from line 11. This is the **amount you owe.** For details on how to pay, see page 19. ▶	13		

Third party designee

Do you want to allow another person to discuss this return with the IRS (see page 20)? ☐ **Yes.** Complete the following. ☑ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign here

Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Joint return? See page 6. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
Gloria M. Perez	2/5/20—	Product Assembler	(606)555-0134
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	

Paid preparer's use only

Preparer's signature	Date	Check if self-employed ☐	Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code		EIN	
		Phone no.	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 36. Cat. No. 11329W Form **1040EZ** (2009)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- Line 10 is a total of lines 7, 8, and 9a.
- Line 11 is for the tax owed on the taxable income amount (from line 6). The tax is found by looking at tax tables provided by the IRS. If filing using a paper form, you can find the tax tables in the paper booklet. Tax tables can also be found on the IRS website.
- Line 12a is for a refund, which results if the amount you owe in tax is less than your tax withholdings and other credits. This amount is found by subtracting tax (line 11) from total payments (line 10). You can have this amount deposited directly to your checking or savings account by filling in the routing and account numbers. Or you can have a check sent to you (which takes much longer).
- Line 13 is the amount of tax you owe, which results if the amount you owe in tax is more than your tax withholdings and other credits. This amount is found by subtracting total payments (line 10) from the tax amount (line 11).
- The "Third party designee" section is where the filer can allow another person to discuss the tax return with the IRS.
- The "Sign here" section is where the filer signs and dates the form.

OTHER TAX FORMS

Form 1040A is a two-page form that allows more options for income and deductions to be entered. Some sections require the filer to attach additional forms, often called schedules. Taxpayers might use Form 1040A instead of Form 1040EZ if they have more than $1,500 in interest income. Form 1099-INT shows the interest income earned during the year. Form 1099-INT is shown in Figure 2-3.6 below. This form is sent to individuals by the bank or other institution that pays the interest.

Figure 2-3.6 Form 1099-INT

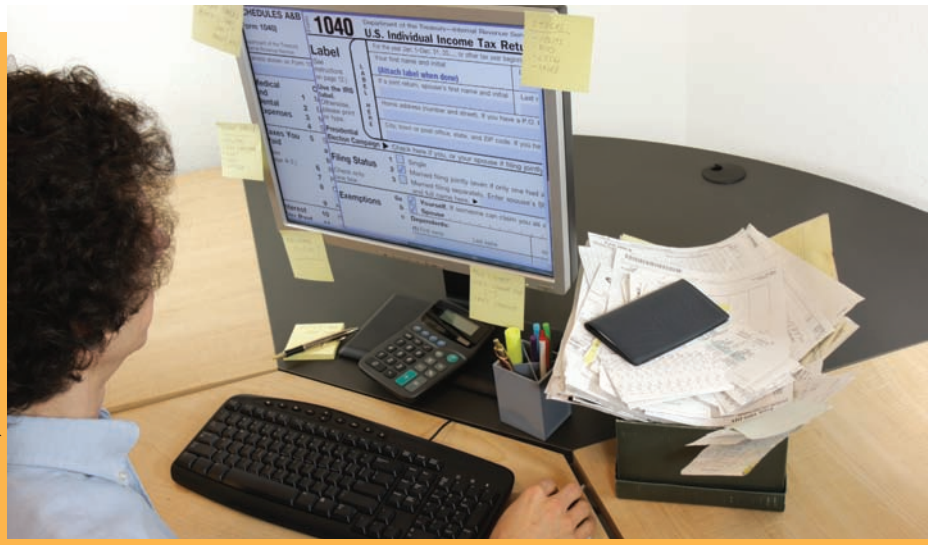
9292 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, ZIP code, and telephone no.	Payer's RTN (optional)	OMB No. 1545-0112	
First Bank 201 Main Street Monticello, KY 42633-0201	1 Interest income $ 2,500.00 2 Early withdrawal penalty $	20— Form **1099-INT**	**Interest Income**

PAYER'S federal identification number	RECIPIENT'S identification number	3 Interest on U.S. Savings Bonds and Treas. obligations		**Copy A For Internal Revenue Service Center File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **20— General Instructions for Certain Information Returns.**
00-0827701	000-22-0011	$		
RECIPIENT'S name Mr. William Patel		4 Federal income tax withheld $	5 Investment expenses $	
Street address (including apt. no.) 206 Brookhaven Drive		6 Foreign tax paid $	7 Foreign country or U.S. possession	
City, state, and ZIP code Somerset, KY 42502-0206		8 Tax-exempt interest $	9 Specified private activity bond interest $	
Account number (see instructions) 4000326	2nd TIN not. ☐	10 Tax-exempt bond CUSIP no. (see instructions)		

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



© Ken Brown, 2010/Used under license from Shutterstock.com

What are the advantages of filing taxes electronically?

Form 1040, also known as the long form, is used by many taxpayers. If you wish to file separately from your spouse or itemize deductions, you must use Form 1040. If you have business income or rents and royalty income, you must also use the long form. The long form is used for complicated tax returns that have special types of income or deductions, from capital gains to foreign investment losses.

E-FILING

E-filing is a fast, safe way to file a federal tax return electronically. Several options are available for using e-file. The filer can hire an authorized IRS e-file provider. This is a tax preparer who is approved by the IRS and can e-file the tax return for you. Most do-it-yourself tax preparation software programs available today support e-filing as well.

Filers who have $57,000 or less of adjusted gross income can use the IRS's Free File program to prepare and file a tax return online for free. A link on the IRS website takes users to a list of companies that provide free filing services. Each company may also have a list of requirements, so a company must be chosen carefully. Once a company is selected, the user answers questions and provides the information needed to complete the return. The filing company sends the return to the IRS electronically.

Using e-file provides fast results. The forms are transmitted instantly to the IRS. Refunds are often received much more quickly than when a paper return is filed. Having the refund deposited directly into a bank account makes receiving refunds fast and safe.

CHECKPOINT

How is gross income different from adjusted gross income and taxable income?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

2-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The short tax return form designed for single and joint filers with no dependents or itemized deductions

_____ 2. A person who depends on you for more than half of his or her support

_____ 3. Total salary or wages earned during the pay period

_____ 4. Tax withheld to pay for medical care of retired persons

_____ 5. The amount of your paycheck after deductions

_____ 6. A withholding tax to provide old-age, survivors, and disability insurance

a. dependent
b. exemption
c. Form 1040EZ
d. Form W-2
e. gross pay
f. Medicare tax
g. net pay
h. social security tax
i. workers' compensation

_____ 7. A form used to report taxable income a worker received during the calendar year

_____ 8. A person claimed as a dependent on a tax return

CHECK YOUR UNDERSTANDING

9. How does the amount of tax a person pays affect the person's disposable income?
10. How is gross pay different from net pay?
11. List three types of required deductions for taxes.
12. List three types of optional deductions from your paycheck.
13. Where can you get current tax forms?
14. What is an exemption as it relates to a Form W-4?
15. What information is found on Form W-2?
16. What form must a new employee complete to claim status as a U.S. citizen, a lawful permanent resident, or an alien authorized to work? Why is this form required?
17. Medicare taxes pay for what services?
18. To whom does workers' compensation pay benefits?
19. Under what circumstances would you file Form 1040A? Form 1040?
20. Why would an individual file taxes using e-file?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Disposable income is affected by taxes that are withheld from a worker's paycheck. Explain how you can minimize tax deductions, such as federal income taxes, from your paycheck. (Hint: Look at Form 1040 to see what is available.)

22. Our system of government works on a principle called "voluntary compliance," meaning that citizens voluntarily file their tax returns and pay the taxes that they owe. Failure to do so can result in criminal charges for tax evasion. Many tax protestors believe that income taxes are unconstitutional and therefore illegal. What is your position on this issue?

23. Every year, Americans celebrate "Tax Freedom Day." Computed by the tax foundation, tax freedom day represents the date on which the average taxpayer has paid off his or her taxes for the year. It is calculated by dividing the official government tally of all taxes collected in each year by all income earned in each year. In 2000, government (federal, state, and local) took 33.6 percent of all income, and Tax Freedom Day was May 3, the latest date ever. In 2009, it was April 13. Use the Internet to research the concept of the Tax Freedom Day. (Hint: Enter the keywords *tax freedom day* into an Internet search engine.) How does it explain what price the nation is paying for government?

EXTEND YOUR LEARNING

24. When you begin a new job, you will be asked to complete a Form W-4 and a Form I-9. To practice filling out these forms, access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 2.
    - From the data files, open and print the file *CH02 Form W-4*. Complete the Employee's Withholding Allowance Certificate portion of the form using your own personal information. For privacy reasons, use 000-22-1111 as your social security number. Indicate that you are single and claim one exemption. Refer to Figure 2-3.2 as an example.
    - Open and print the data file *CH02 Form I-9*. Complete the employee portion of the form in Section 1 using your own personal information. For privacy reasons, use 000-22-1111 as your social security number. Refer to Figure 2-3.3 as an example.

25. To practice filling out Form 1040EZ, access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 2. From the data files, open and print the files *CH02 Form 1040EZ* and *2009 Partial Tax Tables*. Enter your name, address, and social security number in the Label section of the form. For privacy reasons, use 000-22-1111 as your social security number. Assume you are single. Your Form W-2 shows that you have $29,521 of taxable income and $2,850 of federal income tax withholdings. Your 1099-INT shows that you have $421 in taxable interest. Using the provided tax tables, find the amount of tax that applies to the amount of taxable income. Determine if you are due a refund or owe taxes. Sign and date the form. Enter "Sales Associate" as your occupation.

Point Your Browser

www.cengage.com/school/pfinance/pfl

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

TAX COLLECTION

Tax examiners, collectors, and revenue agents work for federal, state, and local governments. They review tax returns to determine the accuracy of the math as well as the credits and deductions claimed. They also identify tax debt and collect taxes owed. Some deal with individual taxpayers, and others work with profit and nonprofit organizations.

Wherever money is collected on behalf of government units, there are revenue agents and officers sending out reports and communicating findings. For each case, careful records are kept and shared among the federal, state, and local governments.

Sometimes travel is needed, but a significant amount of time is spent in offices doing detailed work. Stress results from working under tight deadlines as well as confronting delinquent and often hostile taxpayers.

Employment Outlook

- Growth of 13 percent is expected through 2018.
- Competition will be higher for positions with the IRS.

Job Titles

- Tax examiner
- Tax collector
- Revenue agent

Needed Education/Skills

- A bachelor's degree is preferred.
- Specialized experience is desirable.
- Excellent analytical and communication skills are needed.

Government & Public Administration

What's it like to work in . . . Tax Collection

Alice enjoys analyzing and verifying information contained in tax returns. She compares tax returns with records from other sources such as employers and banks. When there is a discrepancy, she may tag the files for a full audit; in other cases, she is able to determine accuracy with a phone call or a written letter.

The government building where she works is old and historic, but comfortable. Her office is among many others in the Department of Revenue for the state where she lives.

Today is like most others—it involves detailed work that requires concentration, patience, and organization. Her filing system allows her to retrieve information quickly, compare data, communicate through letters or phone calls, and follow up with action when needed.

Alice had to pass a strict background check because she works with confidential information. She is trustworthy, honest, and dedicated to enforcing the tax code.

What About You?

Do you like analyzing data and adhering to procedures? How do your skills and aptitudes match up with those required in the tax collection field?

©Pakhnyushcha, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 2 Assessment

SUMMARY

2-1 Sources of earned income include wages, salaries, tips, commissions, and self-employment. These forms of income are taxable.

Small business owners can set their own hours, keep the profits, and determine what the business will and will not do. But business ownership is often very risky and involves long, hard hours of work.

Employee benefits are important to workers. They are usually not taxed, are offered at comparatively low prices, and help workers reach their financial goals, such as retirement.

Employee benefits include sick leave, personal leave, paid vacations, educational costs reimbursement, perks, group health insurance, retirement plans, profit-sharing plans, and stock option plans.

Flex 125 and HSA spending accounts allow workers to set aside pretax dollars to cover medical costs not paid by insurance.

2-2 Unearned income may come from private sources, such as interest earned on savings and dividends paid on stock, or from government transfer payments.

Government transfer payments can be in-cash payments (check or debit card) or in-kind payments (food stamps, rent subsidies, or vouchers).

Taxes on consumption include use taxes, excise taxes, and sales taxes. These are paid by consumers who use or buy certain goods or services.

Income taxes are based on income. They are called progressive taxes, because the more you earn, the more you pay in tax.

Taxes based on wealth include property taxes and inheritance taxes. They are assessed based on value of property or inheritance.

Everyone benefits directly from taxes in the form of public goods and services, but not everyone benefits in proportion to taxes paid.

2-3 Gross pay is your total salary or wages earned. After taxes and other deductions are subtracted, the result is net pay, or take-home pay.

Federal and state income taxes are withheld based on the number of exemptions you claim on Form W-4. Other required deductions include social security and Medicare tax. Local income and workers' compensation taxes may also apply.

Form I-9 is used to verify a person's eligibility to work in the United States. Form W-2 reports your earnings and withholdings for the year. Form 1040EZ is the short tax return form available to single and joint filers with no dependents or itemized deductions.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Gross pay is calculated by multiplying regular hours times regular pay and adding any overtime hours multiplied by overtime pay. The overtime pay rate is 1½ times the regular rate of pay. Net pay is determined by subtracting deductions from gross pay.
   a. Max worked 44 hours last week. His regular hourly rate is $8.00. What was his gross pay (regular pay plus overtime pay)?
   b. Elaine worked 48 hours last week. Her hourly rate is $9.20. What was her gross pay?
   c. Jackson worked 44 hours last week. His hourly rate is $8.60. He has the following deductions taken from his gross earnings:
      - federal income tax withheld at the rate of 10%
      - social security tax withheld at the rate of 6.2%
      - Medicare tax withheld at the rate of 1.45%
      - health insurance premiums of $12.80
      - union dues of $8.50

      What was Jackson's net pay?
   d. Rachelle worked 46 hours last week. Her hourly rate is $7.90. She has the following deductions taken from her gross earnings:
      - federal income tax withheld at the rate of 10%
      - social security tax withheld at the rate of 6.2%
      - Medicare tax withheld at the rate of 1.45%
      - health insurance premiums of $11.20

      What was Rachelle's net pay?
2. **Ethics** Many employers provide sick leave for employees. Sick leave is a valuable benefit. Employers usually have rules about what situations qualify for use of sick leave. In some cases, the employee must be ill to use sick leave. In other cases, the company may allow employees to use sick leave to care for a sick child or other relative. An employee may also be able to use sick leave to visit a doctor or hospital for tests or checkups. Why is it important for employees to follow the rules that apply to using sick leave? Explain why it is unethical to call in sick when you really have plans to do something else.
3. **Research** When workers are laid off from their jobs, they may be entitled to unemployment compensation benefits. These benefits are taxable income. Each state has unemployment compensation rules. The federal government also has a program. Visit your state's website to find out how unemployment compensation laws and insurance work in your state. Find answers to the following questions:
   a. What are the requirements for drawing unemployment benefits?
   b. How is the amount of the benefit determined?
   c. For how long can a person draw benefits?
4. **History** The income tax was not a part of the U.S. Constitution until 1913. Working in groups, research the history of U.S. taxation and report on the types of early taxes, their rates, and how the taxes were used (such as paying for wars). Also discuss who has the authority to levy taxes, how new taxes are introduced, and how tax rates may be changed.

Teamwork

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5. **Math** Most states have state sales tax which is added to many purchases you make. In the following examples, compute the amount of sales tax and the total purchase price.
   a. Mary bought a new dress for $80, and sales tax in her state is 8.5%.
   b. Jerry bought a pack of 8GB DVDs for $12, and sales tax in his state is 7.4%.
   c. Andy bought a mini computer for $219.99, and sales tax in his state is 5.9%.

6. **Communication** Work in a group with three or four other students to discover and present a plan of action to follow in the event of an emergency.
   a. You have learned that safety procedures and emergency plans are important in the workplace. Such plans are also important in schools. Consult your school handbook, the school website, or other materials available to learn about the emergency plans for your school. You may need to talk with a principal, counselor, or school safety or security officer.
   b. Choose one of the following situations and find the plan that should be followed in that situation. Present the main points of the plan to the class.
      - fire in the building
      - severe weather
      - bomb threat
      - hostage situation
      - chemical spill
      - bus accident

Take Action

PREPARE FORM 1040A TAX RETURN

Point Your Browser

www.cengage.com/school/pfinance/pfl

Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 2. From the data files, open and print the files *CH02 Form 1040A* and *2009 Partial Tax Tables*. Fill in the form based on the following information. Use black ink on the printout, or key the information into the fields of the form. Be sure to double-check your math.

- Assume you are Bill or Mary Smith, single, and claiming one exemption. Use your own address.
- Use 000-22-1111 as your social security number.
- Your Form W-2 shows that you have $28,429 of taxable income and that $2,726 was withheld for federal income taxes.
- Form 1099-INT shows $1,825 in taxable interest.
- Use the standard deduction.
- You have an IRA deduction of $1,000 and student loan interest (deduction) of $500.

From the provided tax tables, find the amount of tax that applies to the amount of taxable income. Determine if you are due a refund or owe taxes. Sign and date the form. Enter "Sales Associate" as your occupation.

Include your completed Form 1040A in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER

3 Your Purchasing Power

3-1 Inflation and the Value of Money

3-2 Prices and Consumer Choices

3-3 Getting More for Your Money

3-4 Consumer Rights and Responsibilities

The money you spend is affected by inflation. Inflation causes prices to rise and erodes the value of money, taking away purchasing power. As a consumer, however, you still have some power. Consumers help set prices when they act in their own best interests by purchasing goods and services that meet their needs. Consumers also need to understand selling and buying strategies and use them to their advantage to increase their purchasing power. Finally, by being aware of consumer protection laws and agencies, consumers can seek protection against unfair selling practices that can affect their spending power negatively.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Key Terms Flashcards
Flash Game
Chapter 3 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-1 Inflation and the Value of Money

GOALS

- Explain inflation and how it is measured.
- List the types of inflation and how they affect consumers.
- Discuss the causes of inflation and how consumer spending, saving, and investing are affected.

KEY TERMS

- inflation, p. 77
- disinflation, p. 79
- reflation, p. 79
- hyperinflation, p. 79
- deflation, p. 80
- demand-pull inflation, p. 81
- cost-push inflation, p. 81
- productivity, p. 82
- real-cost inflation, p. 82
- time value of money, p. 83

What Is Inflation?

The price is the amount a buyer pays for a good or service. **Inflation** is an increase in the general level of prices for goods and services. Inflation reflects how much prices are rising. When prices are rising faster than income, buyers lose purchasing power. In other words, the money workers earn will buy less as prices rise. Changing prices affect the purchasing power of both producers and consumers.

inflation increase in the general level of prices for goods and services

The economy changes over time based on events and on habits and attitudes of producers and consumers. For example, an event such as a flood or hurricane that wipes out crops may affect prices. The supply of crops becomes small compared to demand, driving up price. As new digital devices, such as cell phones and video games, are invented, we are eager to buy them. Because demand for these devices is high, prices are also high.

How does inflation affect you?

Habits and attitudes explain how people react to changes in the supply of goods, world events, and their individual situations. We buy things without thinking about it to support our *habits*. As our habits change, so does our spending. *Attitudes* reflect how people think about their future and about the product being sold. We ask ourselves questions such as: Will this product help me stay healthy? Is it worth the price? As consumers make choices and spend money, they affect prices and inflation.

©Robert Kneschke, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MEASURING INFLATION

Inflation is measured by the U.S. government. The measurement tool used is called the *Consumer Price Index (CPI)*. The CPI uses a list of goods and services that are commonly bought by consumers. The index measures changes in price from a base or starting point in time to the current time (or time of measurement). For example, if the price of an item was $1.00 in the base year and it is now $1.12, that is a 12 percent increase in the price. If the increase happened in just one year and it happened to all the goods on the list, the inflation rate for that year would also be 12 percent. You can learn more about the CPI at the Bureau of Labor Statistics website, as shown in Figure 3-1.1.

The government also gathers information about consumer spending. This information can be found at the Bureau of Economic Analysis website and the U.S. Census Bureau website (see *Statistical Abstract of the United States*). Economists use this information to assess and predict what is happening with the economy.

INFLATION VS. PURCHASING POWER

As inflation rises, the true purchasing power of each dollar falls. That means you must earn more to maintain the same standard of living. If you do not earn more, your standard of living will drop.

Many people receive annual *cost-of-living adjustments (COLAs)* or pay increases from their employers to keep pace with inflation. The COLA does not provide more purchasing power but keeps purchasing power equal to rising costs. On top of the COLA, workers are often given merit raises and/or bonuses. These increases in income provide more purchasing power.

Figure 3-1.1 **Consumer Price Index at Bureau of Labor Statistics Website**

Source: United States Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/cpi/cpifaq.htm.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

How can a cost-of-living adjustment help you maintain your same standard of living?

What Are the Types of Inflation?

Businesses base pricing decisions in part on what consumers are buying and not buying. Changes in prices may show different patterns over time. These patterns result in varying types of inflation.

DISINFLATION

Disinflation occurs when prices are rising, but the rate of increase is slowing down. Some products and services do not increase in price as fast as others. Often, this happens when demand for a product is not the same throughout the year. For example, in spring and summer, the price of swimsuits may be high and rising. In fall and winter, however, if the price is rising, it is doing so at a much slower rate.

disinflation rising prices with the rate of increase slowing down

REFLATION

Reflation occurs when high prices are lowered due to decreased demand, but then are restored to the previous high level. Perhaps you have heard a news reporter use this term to describe crude oil prices. Reflation can happen when the available supply of a product, such as oil, goes up and down. Reflation can also happen when consumers temporarily stop buying a product or service and then, for some reason, start buying it again. For example, when gas prices surge, people may not buy as many big cars and trucks that use more gas. They wait to see what will happen with gas prices. When gas prices fall, they begin buying large vehicles again.

reflation high prices followed by lower prices and then high prices again

©AREANA Creative, 2010/Used under license from Shutterstock.com

How do gasoline prices affect car sales?

HYPERINFLATION

When prices are rising so rapidly that they are out of control, this is called **hyperinflation**. In the United States, there have been periods of double-digit inflation (10 percent or higher in a year). However, hyperinflation rates are much higher. Although there is no set rule,

hyperinflation rapidly rising prices that are out of control

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

many economists consider inflation rates of 50 percent or higher to be hyperinflation. Some countries have had rates of several hundred percent per month. For example, Germany's monthly inflation rate reached over 300 percent in the years following World War I.

The effects of very high inflation rates can be devastating. With hyperinflation, prices are rising so rapidly that consumers spend their money as fast as they can. They do this because they fear that prices will be even higher if they wait. This spending leads to even more inflation. Then people are unable to buy the goods that they need to live comfortably.

While the United States has not experienced hyperinflation (other than rapidly increasing oil prices), it is an event that could happen in the future.

DEFLATION

deflation decrease in the general level of prices for goods and services

Deflation is a decrease in the general level of prices for goods and services. It is the opposite of inflation. In other words, prices are going down. Deflation occurs when producers are willing and able to provide goods and services at lower prices, but due to certain events, consumers are buying less.

Some products go down in price over time even when the market as a whole is not experiencing a period of deflation. For example, a computer that uses a new, faster processor may sell at a high price when it first comes on the market. A year later, the same computer may sell for hundreds of dollars less. The price is lower because it is no longer the newest, fastest computer available. Other, newer models have been released.

©Monkey Business Images, 2010/Used under license from Shutterstock.com

How does deflation affect businesses and consumers?

CHECKPOINT ▸ ▸ ▸

Explain how disinflation differs from hyperinflation?

What Are Causes and Effects of Inflation?

Inflation can be caused by different factors in the economy. Consumers may want to buy more goods or services than are available, driving up prices. Producers may have to pay more for the resources needed to produce products and, thus, may need to raise prices. Both situations can lead to inflation.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

FIGHTING INFLATION

When inflation is rising too fast, it hurts consumers. Two tools are used in the United States to manage the effects of inflation. These tools are called monetary policy and fiscal policy.

Monetary policy refers to actions by the *Federal Reserve System*, commonly called *the Fed*, to stabilize the economy. The Fed is the central bank in the United States created by Congress in 1913. It has many roles, including controlling the money supply. When the Fed sees that prices are rising too fast, it tries to slow them down by decreasing spending. One way to decrease spending is by raising interest rates. When interest rates increase, both individuals and businesses find it more expensive to borrow money to buy goods and services, so spending is slowed.

There are several types of interest rates that are controlled by the Fed:

- The *discount rate* is the rate that banks have to pay to borrow money from the Fed. Banks borrow money when they have the opportunity to make loans but do not have enough cash on hand. Banks are required to have a certain amount of cash on hand, called *reserves*, to meet daily customer demand. If these reserves go below the required amount, banks must borrow money.
- The *federal funds rate* is the rate at which banks can borrow from the excess reserves of other banks. For example, if one bank has more money than it needs, it can loan that extra money to other banks.
- The *prime rate* is the rate that banks charge to their most creditworthy business customers. When the discount rate increases, the prime rate also goes up. The prime rate is usually 3 percent (or more) higher than the discount rate or the federal funds rate.

Fiscal policy refers to actions taken by the federal government to manage the economy. To help curb inflation, the government can raise taxes. When taxes go up, people have less money to spend. This slows inflation. On the other hand, if the economy is sluggish because people are not buying, the government can increase spending by lowering taxes. This gives consumers more disposable income to spend. These actions, taken together, either speed up or slow down spending.

Think Critically

1. How do actions of the Fed affect your life and that of your family?
2. How does raising tax rates help curb inflation?

DEMAND-PULL INFLATION

The most common type of inflation is called demand pull. **Demand-pull inflation** results in higher prices because consumers want to buy more goods and services than producers supply. Consumers may spend their income as soon as it is received and may also be willing to spend future income (credit). This spending causes businesses to scramble to meet the demand for goods. Because products are selling so quickly, businesses are able to raise prices to balance supply with demand and make bigger profits. This type of inflation is often described as "too many dollars chasing too few goods."

demand-pull inflation higher prices as a result of consumers wanting to buy more goods and services than producers supply

COST-PUSH INFLATION

Cost-push inflation occurs when producers raise prices because their costs to create products are rising. For example, when wages go up, the cost of producing a product goes up. Producers may then raise prices. If producers did not raise prices, profits would shrink.

cost-push inflation rising prices as a result of rising production costs

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

productivity a measure of the efficiency with which goods and services are made (comparison of total output to total inputs)

Cost-push inflation is affected by productivity. **Productivity** is a measure of the efficiency with which goods and services are made. It compares total output (quantity of goods or services produced) to total inputs (resources used, such as labor, land, or equipment). When input costs, such as wages or the cost of new equipment, are offset by higher output, such as larger quantities of a product, productivity rises. Higher productivity lowers the cost of each unit produced. Lower costs enable the producer to maintain the same price levels. In this case, cost-push inflation (price increases) does not occur. Instead, more products are made at the same price level.

REAL-COST INFLATION

real-cost inflation rising prices due to scarce resources or increased difficulty in obtaining resources

As resources become scarce or more difficult to get, prices rise in the form of **real-cost inflation**. For example, when there is less natural gas, or companies have to dig deeper to get it, the cost of providing natural gas rises. Over time, resources that are in high demand may shrink in supply. With a growing population's ever-increasing demands, this may happen with many resources. To avoid this type of inflation, people must find other resources to use instead of the one that is scarce.

Creatas Images/Jupiter Images

Why are more businesses hiring during periods of inflation?

INFLATION AFFECTS EMPLOYMENT

Economists believe there is a direct relationship between inflation and employment. Rising prices often are a result of increased demand, which means more people are spending and producers are making more money. Producers, in an effort to keep up with demand, hire more people. Thus, rising prices are associated with higher employment rates. When inflation is reduced and prices drop, the opposite occurs. With reduced demand and lower profits, producers may start laying off workers. This is often called the *inflation/employment tradeoff*. Thus, mild inflation of 2 or 3 percent is said to be good for the economy.

INFLATION AFFECTS SPENDING, SAVING, AND INVESTING

Some jobs provide pay raises only once a year or less often. Employees who do not get raises often enough to keep pace with the inflation rate lose purchasing power. Retirees drawing a fixed monthly pension also lose purchasing power as prices rise. In such cases, consumers have two choices: they can buy less, or they can dip into savings or borrow money

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

to continue the same level of spending. Either way, it takes more money to keep getting the same amount of goods and services.

Inflation also affects the amount of money consumers may be able to save. In times of rising prices, consumers may have to use more of their *disposable income* to buy needed goods and services. Less money may be available for saving.

The **time value of money** is a concept that says a dollar you receive in the future will be worth less than a dollar you receive today. The concept assumes that prices are rising. For example, suppose you loan a friend $20 today. Your friend promises to pay back the $20 one year from today. The money you receive in one year will not have the same value as the money you loaned your friend. This is because prices will be higher and the $20 will not buy as many goods and services one year from today.

time value of money a concept that says a dollar you receive in the future will be worth less than a dollar you receive today

Consumers consider the expected rate of inflation when choosing investments. They want to invest their money in a way that will provide a return that is greater than the rate of inflation. For example, suppose the inflation rate over 5 years is 5 percent. Investments such as savings accounts, stocks, or bonds must have a growth rate of at least 5 percent for the money invested to keep its purchasing power.

Figure 3-1.2 shows the inflation rates as measured by the CPI-U (Consumer Price Index for Urban Dwellers) for 20 years. It shows that we have had low inflation rates over the past 20 years. These rates are low largely due to actions of the federal government and the Federal Reserve System.

Figure 3-1.2 Inflation as Measured by CPI-U, 1990–2009

Year	Annual Inflation Rate CPI-U	Year	Annual Inflation Rate CPI-U
1990	6.1%	2000	3.4%
1991	3.1%	2001	1.6%
1992	2.9%	2002	2.4%
1993	2.7%	2003	1.9%
1994	2.7%	2004	3.3%
1995	2.5%	2005	2.4%
1996	3.3%	2006	2.5%
1997	1.7%	2007	4.1%
1998	2.7%	2008	0.1%
1999	2.7%	2009	2.7%

Source: http://www.bls.gov/cpi/#tables (accessed March 21, 2010).

CHECKPOINT

How can productivity affect inflation?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. Rapidly rising prices that are out of control

_____ 2. High prices followed by drops and then high prices again

_____ 3. Rising prices due to scarce resources or increased difficulty in obtaining resources

_____ 4. A decrease in the general level of prices for goods and services

_____ 5. Rising prices as a result of consumers wanting to buy more goods and services than producers supply

_____ 6. Rising prices with the rate of increase slowing down

a. cost-push inflation
b. deflation
c. demand-pull inflation
d. disinflation
e. hyperinflation
f. inflation
g. productivity
h. real-cost inflation
i. reflation
j. time value of money

_____ 7. An increase in the general level of prices for goods and services

_____ 8. A concept that says a dollar you receive in the future will be worth less than a dollar you receive today

_____ 9. Rising prices as a result of producers' costs increasing

CHECK YOUR UNDERSTANDING

10. What is *inflation*? What causes prices to rise?
11. How is inflation measured? Who provides the data for the measurement?
12. What is the purpose of a COLA? Will your standard of living go up if you receive a COLA? Why or why not?
13. List the types of inflation.
14. What is the *Fed*? What does it do?
15. What are the *discount rate*, the *federal funds rate*, and the *prime rate*? Why are they important?
16. What is meant by *fiscal policy*? How does it help control inflation?
17. How does *demand-pull inflation* differ from *cost-push inflation*?
18. Explain how inflation and employment levels are related.
19. What is meant by the *inflation/employment tradeoff*?
20. How does inflation affect spending, saving, and investing decisions?
21. Explain the time value of money concept as it relates to deflation.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

22. The Consumer Price Index measures changes in price over time. When the CPI rises, that means we have inflation. Explain how the rate of inflation is related to your purchasing power and your standard of living.
23. Make a list of the items you and your family purchase. Based on the changes in price for these items over the past several years, which of the following types of inflation would apply to these items?
    - disinflation
    - reflation
    - hyperinflation
    - deflation
24. How do the actions of consumers cause prices to rise? What can consumers do to prevent inflation in the goods and services they purchase?
25. How do the actions of businesses cause prices to rise? What can workers do to help prevent rising prices?
26. Productivity (which is a comparison of output to inputs) can be raised simply by lowering wages. During recessionary times, businesses freeze wages of employees, reduce the number of employees, and require some employees to work longer hours. Explain how this increases productivity.
27. Explain how the Fed uses interest rates to affect consumer spending.

EXTEND YOUR LEARNING

28. When prices go up, your purchasing power goes down. Identify two items you or your family buys regularly, such as gasoline for a car. Then, for each item, answer the questions that follow:
    a. Has the price gone up or down in the last year?
    b. How much is the price change (in dollars and cents)? What percentage increase or decrease is this amount?
    c. What effect has the price change had on your spending habits? Have you purchased more or less of that product? Have you purchased more or less of something else in order to keep buying that product?
    d. In the long run, what will you do if the price keeps rising? For example, will you find substitutes, stop using the product, or give up something else in order to be able to continue to buy this product?
29. Use the Internet to research the current rate of inflation. Then search for current interest rates on savings accounts and certificates of deposit (CDs). How do the interest rates compare to the inflation rate? If you invest your money in the savings or CD at the current interest rates, what will this mean in terms of its value? What should you do?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-2 Prices and Consumer Choices

GOALS

- Describe three methods of setting prices in a market economy.
- Explain how consumers' buying strategies affect demand and prices in a market economy.

KEY TERMS

- normal profit, p. 86
- cost-recovery pricing, p. 87
- cost-plus pricing, p. 87
- markup, p. 87
- value-based pricing, p. 87
- market-based pricing, p. 87
- rational buying, p. 88
- emotional buying, p. 88
- impulse buying, p. 88
- economizing, p. 89
- optimizing, p. 89

©Diego Cervo, 2010/Used under license from Shutterstock.com

Why must businesses be careful when setting prices?

How Are Prices Set in a Market Economy?

In a market economy, prices are affected by a number of factors. Some factors are controlled by producers, such as their desired profit. Consumers' actions also affect prices in the marketplace. For example, if consumers are willing and able to buy a product, this will cause its price to rise. If consumer demand for a product is low, prices may fall and/or the manufacturer may stop producing it.

Sellers must be careful in setting a price for their product. If the price is too high, consumers may not buy the product. They may not be able to afford the price, or they may simply think the price is too high for the value received. If the price is set too low, consumers may perceive the product as cheap or of low value, causing demand for the product to be low. Also, if the price is too low, the company may not make any profit on the sale of the product. Businesses need a normal profit in order to stay in business. A **normal profit** allows a business to survive as well as grow.

Setting the right price for a product can be tricky. Having products available at the right price is critical to business success. Companies use different methods to set prices. Sometimes more than one method is considered when setting a price. Sellers want to set a price that will support the greatest demand and will be profitable. Some methods of setting prices are discussed in the following sections.

normal profit a profit that allows a business to survive and grow

COST-RECOVERY PRICING

In some cases, the business has invested large sums of money to develop a new product. *Research and development (R&D)* costs can be in the millions

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

or even billions of dollars. Thus, when a product is first introduced, the price will be set high in order to recover the R&D costs. This is known as **cost-recovery pricing**. Because the price is high, it will invite competition, often in the form of *generics*, which are inexpensive substitutes.

cost-recovery pricing setting an introductory price high to recover the R&D costs

COST-PLUS PRICING

Another way that sellers set prices is called **cost-plus pricing**, which involves computing the per-unit cost of producing a product and then adding a percentage of that amount, called a **markup**, to obtain the price. The markup is also called the *profit margin* or *gross profit*. Using this method ensures that the company will make a certain profit if the product sells successfully. An example of cost-plus pricing for a piece of furniture is shown below.

cost-plus pricing setting a price based on production cost plus markup

markup the percentage amount added to production cost to obtain the price of an item

Item	Cost/Unit
Wood, 6 board feet, $3.96 per foot	$23.76
Labor, 2 hours at $10 per hour	20.00
Paint, varnish, nails, and glue	1.24
Indirect costs (workers' benefits, rent, insurance, depreciation, overhead, etc.)	12.00
Total cost	$57.00
Markup (40% × $57.00)	22.80
Price	$79.80

VALUE-BASED PRICING

Using **value-based pricing**, the seller tries to determine how much consumers are willing to pay for the product. In other words, it will be sold for the highest price that the market (consumers) will bear. If consumers value the product or service, they will pay whatever price is set, within reasonable limits. This is especially true of new, high-tech, and fad items. Consumers are willing to pay high prices because there are no less-expensive choices.

value-based pricing setting prices based on how much consumers are willing to pay

Companies may do market research to determine what the demand for a product will be. They also want to learn how much consumers will be willing to pay for the product. Perhaps you have been asked to complete a market survey while shopping at a mall. Telephone and Internet surveys are other popular ways that companies learn about consumers' wants and needs.

MARKET-BASED PRICING

With **market-based pricing**, the price is set to be competitive with prices of similar products currently being sold. If one business charges more than others do for a similar product, consumers are likely to buy from the other businesses to get the lower price. The manufacturer or retailer decides whether or not it can provide the product or service at that existing price and still make a profit. This is the easiest form of setting a price. It helps producers or sellers decide what products to include

market-based pricing setting prices to be competitive with prices of similar products currently being sold

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Joyfull, 2010/Used under license from Shutterstock.com

How can a business differentiate its product or service from others on the market?

in their marketing mix. *The marketing mix* is the group of products or services offered for sale by a business at any point in time. Clearly, what customers want (and are willing to pay to get it) will influence the products offered by sellers.

Sellers who have a similar product to others may try to market their product as different from or better than the other products. This strategy is known as *product differentiation*. For example, a seller offering a new cell phone might cite the phone's small size, Internet capabilities, or other unique features. These features are advertised in a way that makes the new cell phone seem more desirable than the other cell phones on the market. The seller may use these new features to justify charging a higher price. This strategy is not always successful. Consumers may not think the new features are useful or worth the higher price.

CHECKPOINT ▸ ▸ ▸

Name four methods sellers use to price products.

How Do Buying Strategies Affect Prices?

rational buying process of selecting goods and services based on need, want, and logical choices

emotional buying process of purchasing products based on desire rather than logic

impulse buying purchasing something on the spur of the moment without any planning

Consumers play a vital role in setting prices in a market economy. When consumers act in their own best self-interests, they are engaging in rational buying. **Rational buying** is the process of selecting goods and services based on need, want, and logical choices. Sometimes consumers engage in **emotional buying**, which is the process of purchasing products based on desire rather than logic. When you are feeling sad, angry, lonely, or some other emotion, you may make unwise purchases, using your emotions rather than logic to drive the choices. **Impulse buying** happens when people buy something on the spur of the moment without thinking it through or planning the purchase. You might see

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

something in the store and grab it on impulse. Merchants display typical impulse items at key points, such as center aisles, the ends of aisles, and checkout areas. They are hoping the items will catch your eye and prompt you to buy without thinking. Emotional and impulse buying often lead to *buyer's remorse* when you later realize that you made a poor buying decision. In such a case, you may (or may not) be able to return the merchandise for a refund or credit.

There are two basic strategies for rational buying of goods and services: economizing and optimizing. Consumers can use the strategy that best fits their needs for different goods and services. They should also use the strategy that best fits the state of the economy or their bank account at the time. Using both economizing and optimizing strategies at the proper times is the best solution for most people.

ECONOMIZING

Consumers are **economizing** when they are saving as much as possible and spending money only when necessary. Using this approach, consumers wait until it is necessary to buy a product. Then they buy as little as possible and at the lowest price they can find. They do not buy large quantities or more than is currently needed. They simply try to spend as little money as they can for the needed product.

economizing saving as much as possible and spending money only when necessary

Most people go through periods of time when they economize. Others follow this spending pattern all the time. Economizing has its advantages. For example, delaying the purchase of something may result in not buying it at all. Economizing can lead to savings and better buying habits.

For some people, economizing is the only plan that allows them to meet their basic needs. For other people, economizing is a strategy used during certain times as a way to save money for later spending or investing. When economizing, people may spend little or no money on luxuries. People may also spend less on items for basic needs, such as food or clothing. Lower demand for products may lead to lower prices.

OPTIMIZING

Another spending strategy is called optimizing. **Optimizing** is getting the highest value for the money spent. High value may come in the form of purchasing in large quantities or purchasing high-quality products or services.

optimizing getting the highest value for the money spent

For example, if a product that is used often is on sale and stores well, a large quantity can be purchased to take advantage of discount pricing. When items are packaged and sold in large quantities, the cost per item is usually lower than when the item is sold individually.

How can buying in large quantities save money?

©Mastio1, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

TIME MANAGEMENT

Consumers often buy things when they are in a hurry. Those purchase decisions are sometimes not the best decisions. Through *time management*, a person can make better decisions because she or he has planned the purchase and has had sufficient time to make a good choice. Using time-management strategies such as the following can help a person be more productive in school, work, and personal activities.

- Be aware of how you are using your time. This is the first step toward managing your activities in a way that makes the best use of your time.
- Identify *peak performance times*, when you are most productive during the day, and *weak performance times*, when you are the least productive. Schedule activities that involve decision making (such as shopping) at peak performance times.
- Use a daily or weekly planner to keep track of important dates and times.
- Keep a to-do list; mark off items as they are completed.
- Prioritize your activities so that you get the important ones done first.
- Break large projects or tasks into smaller parts, and plan time for completing each part.
- Save some time for doing things you enjoy.
- Do not rush or be pressured for time when making important decisions, such as major purchasing decisions.

Try It Out

Practice your time-management skills by preparing a shopping list for things you would like to buy in the next month. Prioritize the list, putting the items in order of importance. Comparison shop on the Internet. List three locations where you can buy the products on your list, along with the prices at each location. Describe how time management can improve your shopping experiences.

When consumers are optimizing, demand is higher when prices are lower. Customers will buy more of a product to take advantage of lower prices. Consumers should be careful not to let optimizing lead to overspending. Shoppers may buy items they do not need simply because the items are a bargain. Those who stock up on an item may be tempted to use it more frequently because they have a large quantity of it. Then consumers have to buy the item more often to replenish their stock, leading to more overspending.

Overspending can also lead to credit problems. Consumers who want to take advantage of lower prices, may make purchases using a credit card or loan.

When consumers shop carefully and wisely, they help keep prices low. When consumers do not buy wisely, they are part of the problem. Their actions lead to higher prices because of increased demand.

CHECKPOINT ▸ ▸ ▸

How is economizing different from optimizing?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Prices set to be competitive with prices of similar products

____ 2. Purchasing something on the spur of the moment without thinking

____ 3. Profit that allows a business to survive and grow

____ 4. Saving as much as possible and spending money only when necessary

____ 5. The process of selecting goods and services based on need, want, and logical choices

____ 6. An introductory price set high to recover R&D costs

____ 7. The process of purchasing products based on desire rather than logic

____ 8. Setting a price based on cost plus markup

____ 9. Getting the highest value for your money

a. cost-plus pricing
b. cost-recovery pricing
c. economizing
d. emotional buying
e. impulse buying
f. market-based pricing
g. markup
h. normal profit
i. rational buying
j. optimizing
k. value-based pricing

CHECK YOUR UNDERSTANDING

10. Explain why businesses need to make normal profits.
11. Why are the costs of developing a new product so high?
12. How is a market-based pricing strategy different from a value-based pricing strategy?
13. Explain why product differentiation is a needed activity by businesses?
14. What is meant by rational buying?
15. Emotional buying often leads to buyer's remorse. Explain why.
16. What is economizing? How does this buying strategy affect demand and prices in a market economy?
17. What is optimizing? How does this buying strategy affect demand and prices in a market economy?
18. How can using effective time-management strategies lead to better buying decisions?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. In a market economy, both sellers and buyers must act in their own best interests. A seller is entitled to normal profits in order to remain in business and grow. Some companies charge markups of 10 percent, while others charge markups of 100 percent or more. What markup rate do you think represents a normal profit? Does it depend on the type of business?
20. Consumers' buying habits greatly affect prices. Explain what consumers can do to help keep prices reasonable.
21. New products, especially in the field of technology, are in high demand and are very expensive when they are first introduced. Can you give an example of a product that was initially very expensive, but the price dropped after a year or so? Why did the price drop?
22. Think of an item you would like to buy that costs more than $50 and that will require some planning, saving, and shopping. Perhaps it is a gift for someone's birthday or a special item that you have wanted for some time. List the things you will consider before buying, such as places you will shop, features you are seeking, and the maximum price you are willing to pay. Describe where you will go and what you will do while shopping. This includes the stores (and websites) you will visit, questions you will ask, and techniques you will use to get the best deal. Explain what you will do after the purchase, such as keep the receipt, mail a warranty card, or follow up on delivery. If available, use spreadsheet software to compile your list.

EXTEND YOUR LEARNING

23. List three items your family has purchased in the last year—something with a high price ($100 or more), a medium price (between $25 and $100), and a low price (under $25). Answer the following questions:
    a. How do you think the price was set for this product—using cost-recovery, cost-plus, value-based, or market-based pricing? Why?
    b. Was this item purchased as a result of economizing or optimizing?
    c. If you had to make this purchase decision again, would you choose the same item? Why or why not?
24. Many companies that have traditional stores also have a retail website. Ordering merchandise online is usually convenient and easy. As a result, consumer purchases on the Internet are rapidly growing. Working with a partner, identify a large and well-known department store. Visit the store's website and answer the following questions:
    a. Is the site easy to navigate and organized so that you can quickly find the items in which you are interested?
    b. Is complete information provided for each product?
    c. Are special prices offered for online purchases?
    d. Are you able to proceed to checkout (if you wish) with ease?
    e. Overall, how would you rate your shopping experience at this site?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-3 Getting More for Your Money

GOALS

- Describe strategies used by businesses to sell goods and services, both in meeting and in creating demand.
- Discuss strategies consumers can use before, during, and after a purchase.

KEY TERMS

- branding strategy, p. 94
- discount pricing, p. 94
- advertising, p. 94
- target audience, p. 94
- banner ads, p. 95
- pop-up ads, p. 95
- direct advertising, p. 95
- customer loyalty program, p. 96
- transit advertising, p. 96
- comparison shopping, p. 98

What Are Selling Strategies?

Business owners take the risk of bringing products and services to the market. To stay in business, they must sell those products and services to customers and make a profit. Sellers must consider ways to meet demand as well as ways to create more demand for their products and services.

MEETING DEMAND

Sellers use many strategies to promote products and services that customers buy to meet their needs and wants. Strategies may include having a convenient store location and convenient payment options, offering good customer service, and providing the right product at the right time and at the right price.

Convenience

One strategy businesses use to promote sales is to make shopping convenient and pleasant for customers. A store location that is easy for customers to find and near other businesses makes shopping there convenient. Providing a clean, comfortable, and safe place to buy goods and services makes the shopping experience pleasant.

As another convenience, many businesses offer customers a wide range of payment options. Customers may pay using cash, checks, debit cards, and credit cards.

Customer Service

Businesses depend on their employees to provide good customer service as a way to promote sales. Good customer service includes a warm, friendly greeting and prompt and courteous help when it is needed. A good customer service experience increases the chances that shoppers will return to the store to buy again. Satisfied customers also tell others about their experience. This word-of-mouth promotion is good for sales.

Digital Vision/Getty Images

What makes a buyer become a loyal, repeat customer?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Poor customer service may keep shoppers from returning to buy again. Even if prices are low or the store is in a convenient location, shoppers may not return if they have had a bad experience. Dissatisfied customers will also tell others about their experience. This message can be very harmful to future sales.

The Right Product and Price

Businesses try to make available to customers the types of products they need or want. Some businesses may try to meet customers' basic needs by selling food or clothing. Other businesses may try to appeal to a customer's need to save time by selling appliances such as washing machines, microwaves, or power tools. Customers who desire to feel or look young may shop at businesses that sell cosmetics, fitness equipment, or vitamin supplements.

Many consumers only want to buy brand-name products that are well known and dependable. Stores that use a **branding strategy** carry certain brands to attract customers who are loyal to those brands. Making the right products available to customers increases the chances of success for a business.

branding strategy carrying well-known brand names to attract customers who are loyal to those brands

In addition to offering the right product to customers, businesses must charge the right price. Many businesses offer discount pricing. With **discount pricing**, a business offers the lowest everyday price possible. Because the business's prices are generally lower than those offered by competitors, it may need to cut costs by selling slightly lower-quality products, hiring fewer salespeople, and providing a less-appealing atmosphere or a less-convenient location. But customers who are very price sensitive will shop at the business to get the lower prices.

discount pricing offering the lowest everyday price possible

CREATING DEMAND

To sell goods, businesses may need to create or stimulate demand. **Advertising** is informing consumers about products and encouraging them to buy. Advertisements, or *ads* for short, come in many different forms, but they all have the same purpose—to attract customers. Ads are created for a **target audience**, which is a specific group of people who are likely to buy the product.

advertising informing consumers about products and encouraging them to buy

target audience a specific group of people who are likely to buy a product

Newspaper and Magazine Advertising

Placing ads in newspapers and magazines is a popular way to reach large numbers of people. The ad may promote a product or a company. It may be a short one-color ad or a full-page color ad showing many products. Typically, ads include special prices or other incentives to get customers into the store.

Television and Radio Advertising

Television ads are very expensive, but they can reach millions of people. They are written to appeal to a target audience who is likely to be watching a specific program. For example, some groups watch news programs. Others are sure to tune in for sporting events. Companies design ads that will appeal to these target audiences. They run the ads on certain shows and at specific times.

Radio advertising attracts audiences with special interests. Radio programs range widely in content. News programs, talk shows, religious

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

messages, and many types of music can be found on the airwaves. Radio ads often involve appeals to emotions. They may use slogans or have catchy tunes. As with TV ads, radio ads target groups of people who are likely to be listening to a particular program.

Internet Advertising

The Internet is a popular place to shop. Many types of advertising can be found on the Internet. **Banner ads** span the top, bottom, or sides of a web page. They have bold statements or pictures that grab the user's attention and invite them to click on a link for more information. **Pop-up ads** open new windows and "pop" onto the screen in front of the web page the user is viewing. The user must click "No" or a similar command to close them. Overuse of such ads on a site can be annoying, so advertisers should use them with caution. Some people buy special software to block pop-up ads.

banner ads Internet ads that span the top, bottom, or sides of a web page

pop-up ads Internet ads that open a new window that pops onto the screen in front of the web page being viewed

Many online retailers customize ads to shoppers who have visited their site. The user logs in and does some shopping, while the site tracks the products clicked and web pages visited. The tracking is often done through the use of *cookies*, which are files created by the website that store information about the web visitor on his or her computer. Most cookies are harmless. They enable the website to recognize the shopper in the future. They may also contain information about products the user viewed or bought in the past. Using this information, the website may customize ads displayed on the web page or suggest additional items that would compliment a product in the visitor's shopping cart. Some online sellers share customer data with other websites. Shoppers may get e-mails, pop-ups, or other ads from online sellers they have never visited.

©Yuri Arcurs, 2010/Used under license from Shutterstock.com

Why is Internet advertising so popular?

Some sellers send *electronic ads* in the form of e-mails to encourage customers to buy. These ads feature pictures and prices of products, special sales events, and discounts. As a customer, you can sign up to receive them and are usually able to opt out or unsubscribe if desired.

Billboards, Signs, Circulars, and Brochures

Some businesses direct their advertising to the masses instead of a specifically targeted audience. These businesses consider all of the consumers in a general area as potential customers. Billboards and signs may be posted along highways or at store entrances. Circulars and brochures may be delivered by U.S. mail to every home within the business's zip code.

Direct Advertising

Direct advertising distributes information about a product directly to consumers. It involves actions such as sending free samples or coupons in the mail and giving out samples in a store, allowing the customer to try the product.

direct advertising distribution of product information directly to consumers

One form of direct advertising is *direct sales*. A salesperson goes door-to-door to give customers a catalog or to show them a product. Another method is holding a party to sell products to a group of friends.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

CREATIVE LISTENING

Creative listening is a skill used to solve problems. With *creative listening*, a person searches through information and forms questions to ask. The listener evaluates what was heard and makes a decision or choice. Creative listening is a highly active process that involves logic as well as listening.

For example, suppose you are listening to a debate about a new law that has been proposed. One side is listing its positive features and all the reasons why you should vote in favor of it. The other side is explaining all the bad things that will happen if the law is enacted. In order for you to decide, you must listen carefully, make sure you have accurate information, and come to a decision that will be your vote. Creative listening requires that you understand who is proposing the law and what that group has to gain. You also need to know who is opposing the law and what that group has to lose. By practicing creative listening, you can reach an informed decision.

Try It Out

Listen to a commercial on a television program. List what you learned from the ad and the information you gained. List the questions you still have after viewing the ad. Are you convinced that the ad has given you the full and accurate information you need to make an informed buying decision?

This approach takes the product directly to the consumer, using a person-to-person approach. *Telemarketing* is another form of direct selling in which salespeople call consumers to market a product or service.

Customer Loyalty Programs

customer loyalty program a program designed to encourage a customer's repeat business by providing discounts and other incentives

Many businesses today, from grocery stores to airline carriers, have one form or another of a customer loyalty program. A **customer loyalty program** is designed to encourage a customer's repeat business by providing special discounts and other incentives. For example, a *rewards feature* in a customer loyalty program may give customers cash back for repeat purchases. Or it may provide free services, coupons, gift cards, or other forms of payback.

Other Types of Advertising

transit advertising print ads or signs appearing on public transportation

There are many other forms of advertising. Some are subtle and indirect, such as placing coupons in entertainment books. Others are upfront and bold, such as costumed characters waving signs to promote a business. **Transit advertising** consists of print ads or signs on public transportation, such as buses or subways. Telephone directories contain ads similar to newspaper ads. Whatever method is used, advertising must catch the consumers' attention and generate interest in the product or service.

CHECKPOINT ▸ ▸ ▸

How do businesses meet consumer demand? How do they create demand?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Are Consumer Buying Strategies?

Sellers have strategies to encourage you to buy. As a consumer, you should have strategies to help you maximize your purchasing power. Some ideas to help you in your role as consumer are given in the following sections.

BEFORE YOU SHOP

Before going to the store, prepare a shopping list of the things you need. Base your list on well-thought-out ideas, such as a menu plan. Decide ahead of time what you will buy and approximately how much you will spend. Also, plan how you will pay for the items. Planning ahead will help you avoid overspending or buying items you do not need.

For major purchases, you may deal with a salesperson who is paid on commission. Because the salesperson's commission is based on total sales, he or she may encourage you to spend more than you intend. Plan your strategy ahead of time. Prepare questions to ask. Do not allow a salesperson to convince you to spend more than you planned. The key to effective planning is knowing what you want to buy and how much you want to spend.

WHILE YOU SHOP

While at the store, stick to your list and avoid impulse buying. Check prices to make sure you are getting the best deal. Do not shop when you are experiencing an extreme emotional state. Being hungry, sad, angry, frustrated, or even especially happy can affect your state of mind and your choices.

If you have made a decision about how much you will spend for an item, stick with it. Do not make on-the-spot decisions or allow yourself to be pressured into buying something that you may regret later. If necessary, take someone with you to give you support. Do not select last-minute purchases at the checkout line. These items are often high-priced, low-value merchandise. Also, do not buy something just because it's on sale.

Shop when you are most alert. Find times when you can get good customer service. This often means early or late, rather than rush times. You'll have a better experience, get answers if you need them, and avoid the frustration of long waits. And remember the following rule of thumb: When in doubt, don't! Postponing a decision is often your best decision. Many people change their minds after a "cooling off" period of 24 hours.

AFTER YOU BUY

Keep the receipts and warranties for all items purchased. Remove a product carefully from its packaging. If there is a box or bag, keep it until you are sure that you have all the pieces for the product and that it works properly. If you need to return an item, be sure all the pieces are back in the package.

Evaluate your purchase. Are you satisfied with the product? Is it what you had intended to buy? Are you satisfied with the service you were given? Answering these questions will help you make better decisions in the future.

Also think about the buying experience itself. Become a loyal customer to businesses that have met your needs and served you well. Tell others about your good experiences. On the other hand, when you are treated unfairly, take your business elsewhere.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

ONLINE SHOPPING

With online shopping, consumers have the convenience of buying products without leaving their home. Many successful businesses have a retail website. These sites provide an alternate location for consumers to buy goods and services. The total amount paid for goods, however, may be slightly higher because of *shipping costs*. Some businesses may not keep all types or models of their products in their stores. They may offer additional products or more sizes and colors online. Some businesses do not have a store that consumers can visit and sell online only.

Retail websites typically provide full descriptions of products, including pictures. Shoppers need a computer with enough speed and memory to open web pages to view products. Shoppers can save items to a virtual shopping cart and checkout at the time of selection or at a later time.

Online shoppers need to be certain they are shopping at a secure website that will protect their identity and credit card numbers. Read the website's privacy and security policies. Before completing the checkout process, be sure an "s" appears in the website's address (https). The "s" means secure. Print and keep confirmation numbers and e-mails regarding your order. Know the shipping and return policies.

COMPARISON SHOPPING

comparison shopping the process of checking prices among several sellers to make sure you are getting the best price for what you buy

Whether shopping in person or online, an important buying strategy is to compare prices. **Comparison shopping** is the process of checking prices among several sellers to make sure you are getting the best price for what you buy. You can shop at several stores to compare prices, brands, quality, services offered, and so forth. Many people use the Internet for comparison shopping, where they can learn about product prices and features in the convenience of their home without feeling pressured to buy.

NET Bookmark

Edmunds.com is a website that allows shoppers to quickly compare prices and features of similar vehicles. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 3. Look up a vehicle that interests you and add as many options as you like. What is the invoice price? Now select a vehicle that Edmunds cites as a competing model and compare its features and prices. What do you think is the most valuable information offered on the Edmunds site?

www.cengage.com/school/pfinance/pfl

CHECKPOINT

Why is comparison shopping important?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Distributing product information directly to consumers

____ 2. Offering low everyday prices, generally lower than competitors

____ 3. Internet ads that open a new window in front of the web page being viewed

____ 4. Internet ads that span the top, bottom, or sides of a web page

____ 5. Print ads or signs on public transportation

____ 6. Informing consumers about products and encouraging them to buy

____ 7. Process of checking prices among several sellers

____ 8. Carrying well-known brand names to attract customers who are loyal to those brands

____ 9. A specific group of people who are likely to buy a product

a. advertising
b. banner ads
c. branding strategy
d. comparison shopping
e. customer loyalty program
f. direct advertising
g. discount pricing
h. pop-up ads
i. target audience
j. transit advertising

CHECK YOUR UNDERSTANDING

10. List three ways businesses meet customer needs and wants, other than with pricing strategies.
11. Explain the concept of discount pricing as a selling strategy.
12. List three types of advertising that sellers can use to help create demand for a product.
13. Explain the concept of a *target audience*. Provide one example.
14. List three ways businesses use the Internet to stimulate new sales.
15. List three things you can do before you shop to improve your purchasing power.
16. List three things you can do while shopping to make better purchase decisions.
17. Discuss things you can do after a purchase to help ensure a better shopping experience now and in the future.
18. Explain how you can use the Internet to enhance your buying skills.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. Businesses work hard to earn your business and meet your needs. What is your favorite place to shop? Make a list of how the business meets your needs in the following areas: (a) convenience, (b) customer service, and (c) pricing or branding. Do you think this is part of the business's selling strategy? Explain your answer.
20. Advertising is designed to create need. How many times have you purchased something because of a TV ad, an in-store display, a newspaper ad, or some other source? To what needs were the ads appealing? Were you satisfied with your purchase? If you had it to do over again, would you still buy the product or service?
21. Which buying strategies do you use in your daily life? Describe what you do before you go shopping. How long does the process take? Describe what you do while you are in the store—do you stick to your list or the product you had decided to purchase, or are you influenced by strategic displays and salespersons? When you have completed a purchase, do you ever regret it? If so, what do you do about it? Are there things you would like to change about your personal buying habits? Explain.

EXTEND YOUR LEARNING

22. Shopping is something everyone has to do. Goods and services are promoted through various methods of advertising. How many times have you thought that you were misled by an advertisement? Have you been convinced to buy something that you later thought was not worth the money? Choose one of the methods of advertising below. Then describe the target audience and the appeal for the ads it shows.
    a. Watch television for one-half hour. During that period, write down every ad (commercial) you watch. For each ad, describe the group of people you think the ad is targeting. Then tell whether the appeal is rational (meets real needs) or emotional (creates a desire for a product). Tell whether or not you think the ad is effective, and explain why.
    b. Listen to a local radio station for one-half hour. Write down every commercial you hear. For each ad, describe the people you think are in its target audience. Then tell whether the appeal is rational or emotional. Tell whether or not you think the ad is effective, and explain why.
    c. Look through a daily newspaper or magazine. Make a list of the types of advertisements you find. For each type of ad, describe the target audience. Then tell whether the appeal is rational or emotional. Tell whether or not you think the ad is effective, and explain why.
    d. Go to a business website and look for specific products that interest you. Evaluate the website in terms of how it met your need. Describe the effectiveness of the site's design as well as its ease of use in finding the desired information.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-4 Consumer Rights and Responsibilities

GOALS

- Describe your rights as provided by major consumer protection laws, and list sources of consumer assistance if you have a complaint.
- Describe common deceptive practices that defraud consumers.
- Discuss your responsibilities as a consumer to protect yourself from consumer fraud.

KEY TERMS

- time-shifting, p. 102
- space-shifting, p. 102
- warning label, p. 103
- deception, p. 106
- bait and switch, p. 106
- low-balling, p. 106
- pyramid scheme, p. 106
- Ponzi scheme, p. 107
- pigeon drop, p. 107
- infomercial, p. 108

What Are Consumer Rights?

For many years, the consumer's role in the marketplace was known as "buyer beware." Consumers had little protection against unfair practices. Today, that position is changing. As abuses have become apparent, new rights for consumers have been established. By knowing and understanding your consumer rights, you can better protect your purchasing power.

LAWS DEFINING CONSUMER RIGHTS

Many laws have been passed to protect consumers, such as those described below. Other laws are being proposed to help consumers, including one that would create a new federal agency whose sole purpose would be to enforce consumers' rights.

The Consumer Bill of Rights

One of the most important steps toward consumer protection was the Consumer Bill of Rights of 1962. It grants consumers the following rights:

- *right to safety* from unsafe products
- *right to be informed* of the facts necessary to make good choices
- *right to choose* amongst a variety of quality products at competitive prices
- *right to be heard* to ensure consumer interests are represented when laws are being written and enforced
- *right to redress* in the form of compensation for complaints and injuries
- *right to consumer education* in the form of programs and information that will help consumers make better decisions

Airline Passenger Rights

In 1999, it became apparent that airline passengers were being treated unfairly. A new law was passed to guarantee the following:

- *Confirmed reservations*. When you have a confirmed reservation, you will be provided a seat on the flight.
- *Refunds*. When a ticket is cancelled, you will be issued a refund. If the ticket is nonrefundable, you can apply the fare to a future flight.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- *Compensation for hardships*. If delays, cancellations, or "bumps" due to a flight being oversold occur, compensation is required.

Consumer Technology Bill of Rights

As a result of the widespread use of computers, new rights were passed to protect consumers as follows:

time-shifting recording video or audio for later viewing or listening

space-shifting copying the contents from one form of media to another for personal use

- *Time-shifting*. Consumers have the right to time-shift. You are **time-shifting** when you record video or audio for later viewing or listening.
- *Space-shifting*. Consumers have the right to use content in different places. **Space-shifting** allows you to copy the contents of a CD or other media to a portable or other device for personal, not commercial, purposes.
- *Backup copies*. You are allowed to make backup copies of purchased CDs, DVDs, and other media in case they are destroyed.
- *Platform of choice*. You are allowed to listen to music on whatever device you choose. For example, you can use your MP3, iPod, iMax, or Linux.
- *Translation*. You can translate legally acquired content into a format that makes it more usable to you. For example, a blind person can modify an electronic book so it can be read out loud.

Patients' Bill of Rights

Between 1998 and 2001, abuses in managed care and other related medical services led to the following rights:

- *Informed disclosure*. You have the right to receive accurate, easily understood information so you can make informed health care decisions.
- *Choice of providers*. You have the right to choose your own doctor and other health care provider.
- *Access to emergency services*. You have the right to access emergency services when and where the need arises. The health plan insurer must pay for the cost of that service and cannot insist you use a provider on its restricted list.
- *Treatment decisions*. You have the right to participate in all decisions related to your health care.
- *Respect and nondiscrimination*. You have the right to considerate, respectful care from all health care providers.
- *Confidentiality*. You have the right to confidentiality regarding your health care information.

CONSUMER PROTECTION LAWS

Since the 1930s, Congress has passed many laws to protect consumers from unsafe, unfair, and deceptive practices. These laws help ensure that consumers get quality goods and services for their money.

Food, Drug, and Cosmetic Act of 1938

The Food, Drug, and Cosmetic Act requires that foods be safe, pure, and wholesome. It also requires that drugs and medical devices be safe and effective and that cosmetics be safe for human use. Truthful labeling is also required. The FDA approves drugs before they can be sold. Approval takes years of research, testing, and proof of effectiveness and safety.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Hazardous Substances Act of 1960

As a result of the Hazardous Substances Act, warning labels must appear on all products that are potentially dangerous to consumers. When product defects are unacceptably dangerous, *recalls* are required, meaning the product is returned to the manufacturer for refund or repair.

Kefauver-Harris Drug Amendment of 1962

The Kefauver-Harris Drug Amendment strengthened the Food, Drug, and Cosmetic Act by requiring drug manufacturers to test drugs for safety and effectiveness before they are sold to consumers. This law also allows the sale of generic drugs. A *generic drug* is a medication with the same composition as a brand-name drug, but it is much less expensive.

©Diego Cervo, 2010/Used under license from Shutterstock.com

How can consumers be sure the products they buy are safe?

Cigarette Labeling and Advertising Act of 1965

To meet the requirements of the Cigarette Labeling and Advertising Act, warning labels regarding health hazards must be clearly visible on products. A **warning label** contains information advising consumers of product risks and safety issues. Today, warning labels are much more specific about potential dangers and risks than they were in the past.

warning label information on products advising consumers of risks and safety issues

National Traffic and Motor Vehicle Safety Act of 1966

National safety standards for automobiles and for new and used tires were established in the National Traffic and Motor Vehicle Safety Act. Testing and inspections are required to be sure they meet minimum standards for safety.

Care Labeling Rule of 1971

Clothing and fabrics must be labeled permanently with laundering and care instructions as required by the Care Labeling Rule. *Care labels* give instructions for cleaning, wash and dry temperatures, and other care needed to preserve the product. The labels must stay attached and easy to read for the life of the garment.

Nutrition Labeling and Education Act of 1990

The Nutrition Labeling and Education Act states that detailed information is required on all food and drinks. Labels must disclose the amount of nutrients in food, including the amount of calories, fat, salt, and other ingredients. In 1993, the act was extended to restaurants that must comply with health claims on signs and menus.

Family Educational Rights and Privacy Act (FERPA) of 1974

FERPA is a federal law that protects the privacy of student records. Information may not be released without consent of a parent (or the student after age 18). To protect students from identity theft, social security numbers may not be used as student ID numbers.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Health Insurance Portability and Accountability Act (HIPAA) of 1996

HIPAA protects your health and billing information, including information stored on a computer network, by limiting who can have access to it. Consumers are allowed to have a copy of health records, to make corrections, to know how information is being used, and to decide whether or not to give permission to share the information. Social security numbers may not be used for patient identification.

SOURCES OF CONSUMER PROTECTION

When you need assistance with a consumer problem, there are numerous federal, state, and local sources of help. Most of these sources have websites where you can find advice and information and file complaints online.

Federal Agencies

Many federal government agencies provide information of interest to consumers. Some of these agencies handle consumer complaints, and others direct complaints to agencies or sources that address consumer issues.

- *U.S. Department of Agriculture (USDA)*. The USDA inspects food to ensure wholesomeness and truthful labeling. The *USDA Food and Nutrition Service* provides food assistance programs, information on diets and nutrition, and menu preparation. The *Cooperative Extension System* partners with the USDA to provide educational materials in every state.
- *Food and Drug Administration (FDA)*. The FDA enforces laws and prevents or stops the selling of mislabeled foods, drugs, cosmetics, and medical devices. It also provides standards and guidelines for poisonous substances, investigates complaints, researches substances found to be dangerous, and issues warnings to consumers about unsafe products.
- *Consumer Product Safety Commission (CPSC)*. The CPSC protects consumers from risk of injury or death from uses and foreseeable misuses of consumer products. It bans products that are dangerous, arranges recalls, and researches potential hazards.
- *Federal Communications Commission (FCC)*. The FCC regulates interstate and international communications by radio, television, wire, satellite, and cable.
- *Federal Trade Commission (FTC)*. The FTC restricts unfair methods of competition, false or deceptive advertising, inaccurate information on credit reports, and concealment of the true cost of credit. The FTC is also the federal clearinghouse for complaints of identity theft.
- *Federal Aviation Administration (FAA)*. The FAA controls air traffic and certifies aircraft, airports, pilots, and other workers. It writes and enforces air safety regulations.
- *Securities and Exchange Commission (SEC)*. The SEC protects investors and oversees the securities (stocks and bonds) markets. It requires companies to disclose financial and other information so that investors can research investment options. It also investigates the mishandling of investments by securities professionals.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

State and Local Assistance

Most states have a consumer protection agency or a state attorney general's office that handles consumer complaints. County and city governments also have consumer protection offices. Many of these have websites where consumer complaints can be filed. Consumer leagues and public-interest research groups are also active at the state and local level. They publish informational newsletters, pamphlets, handbooks, and websites on current consumer issues.

Private Organizations

There are many private organizations that consumers can access when they need to get information or file complaints.

- *The Better Business Bureau (BBB)*. The BBB is a clearinghouse of information about local businesses. Consumers file complaints about businesses, businesses are given the opportunity to respond, and the BBB suggests solutions. Consumers can also view complaints filed against businesses by other consumers.
- *The Major Appliance Consumer Action Panel (MACAP)*. The MACAP is comprised of representatives of the home appliance industry. It provides assistance in resolving consumer complaints in the purchase and use of home appliances. A similar group also exists for the automobile and furniture industries.
- *The National Consumers League (NCL)*. The NCL operates the National Fraud Information Center, established in 1992, to combat fraud against consumers. In 1996, the Internet Fraud Watch was created. You can get information as well as file complaints at the NCL website.
- *Consumers Union (CU)*. The CU is a not-for-profit organization. It has a consumer testing facility to test and evaluate products (including cars) sold to consumers. It publishes a monthly magazine, *Consumer Reports,* which provides test results and product ratings. It also publishes an annual *Buying Guide* that summarizes the year's reports and ratings.

©Diego Cervo, 2010/Used under license from Shutterstock.com

How does the BBB help protect consumers?

Public Officials

National, state, and locally elected officials are also available to you. You can visit them in person, call them, send an e-mail, or send a letter. Most public officials have websites where constituents can find contact information. Consumer issues are of interest to them, because they represent voters. In some cases, they will investigate and provide direct assistance to consumers. Your voiced concerns may result in new laws and ensure government enforcement of existing ones.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

What consumer protection law has been passed to protect consumers in the area of technology? List two provisions of this law.

How Are Consumers Defrauded?

deception false or misleading claims made about the quality, price, or purpose of a product

The marketplace is full of deceptive and misleading information and unfair practices. **Deception** occurs when false or misleading claims are made about the quality, price, or purpose of a product. In many cases, little can be done once the consumer has been duped into making a purchase. To avoid this, it is important to be aware of unfair practices and schemes.

BAIT AND SWITCH

bait and switch an illegal sales technique in which the business advertises a bargain product with the intent of persuading consumers to buy a more expensive product

Bait and switch is an illegal sales technique in which a business advertises a bargain product with the intent of persuading consumers to buy a more expensive product. The "bait" is the bargain that draws you into the store. When you get there, the salesperson will try to "switch" your interest to a more expensive product. The bait is usually poor quality, which becomes obvious once you are in the store. It is advertised to be of better quality than it is, giving consumers the idea that it is a bargain.

FAKE SALES

A common consumer fraud is the *fake sale*. A business advertises a big sale but keeps items at regular price. Often the business will alter the price tags by raising the price and then marking it down to regular price, making you think it's a lower price. Just because an item is marked "on sale" does not mean the price has actually been reduced.

LOW-BALLING

low-balling advertising a basic service at an unusually low price and then claiming additional repairs or services are needed

Repair shops sometimes use a practice known as low-balling. **Low-balling** is advertising a basic service at an unusually low price to lure in customers and then telling them that they need additional repairs or services. If the customer refuses the added repairs, the shop then charges extra fees for reassembly. Thus, that "free brake inspection" may not be free at all.

PYRAMID SCHEMES

pyramid scheme an illegal multilevel marketing gimmick that promises commissions on one's own sales as well as on the sales of recruits

A **pyramid scheme** is an illegal multilevel marketing gimmick that promises people high commissions on their own sales as well as on the sales of other people they recruit. A cash investment is often required to become a "distributor" of the products being sold. The pyramid consists of those at the top who make money by selling the products to the distributors and earning commissions from every sale made by their recruits. Many in the middle also make money on sales. However, most of the lower-level recruits make little or no money as they try to recover their initial investment by selling the products to their friends and relatives.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

PONZI SCHEMES

A **Ponzi scheme** is a fraudulent investment operation in which money collected from new investors is used to pay off earlier investors. Investors give money to an "expert" investor who promises very high returns. The "expert" takes their money and, for awhile, pays high returns from the inflow of cash from new investors. The scheme works well as long as new investments are incoming. It falls apart when the "expert" disappears with the money, new investments slow, investors make withdrawals during downturns in the economy, or auditors discover problems with the financial records of the investment firm. While the "expert" often receives a prison term, the investors suffer financial losses because usually their money cannot be recovered.

Ponzi scheme a fraudulent investment operation in which money collected from new investors is used to pay off earlier investors

PIGEON DROP

A scam in which a con artist convinces a person to give up his or her money in return for a share of a larger sum of money is called a **pigeon drop**. The "pigeon" is an unsuspecting person who has money. Senior citizens are often targeted. One of the most common pigeon drop scams occurs when a con artist approaches a victim claiming to have found a large sum of money and offering to split the money. The con artist sets up a phony meeting to discuss dividing up the money. In the meantime, the con artist asks the victim to put up some of his or her own money to prove that he or she is trustworthy. Later, when the victim arrives at the meeting spot, the con artist is nowhere to be found. In another pigeon drop scam, a con artist convinces victims to use their checking account to assist in the transfer of an international deposit in return for a portion of it. The victims must send a personal check for the amount of the deposit to another recipient until the international check clears. The victims later discover the check is worthless. This scam is commonly originated online.

pigeon drop a scam in which a con artist convinces a person to give up his or her money in return for a share of a larger sum of money

FRAUDULENT REPRESENTATION

Telephone or door-to-door solicitations made by people who claim to represent well-known companies or charities are another type of swindle. Consumers may end up buying worthless or unusable products or donating money to a fictitious charity. Before giving money to solicitors, check to verify their identity. Ask them to show official documentation regarding the organization and call to verify that it is real. Investigate charities online through the BBB's Wise Giving Alliance (www.give.org).

©Lisa F. Young, 2010/Used under license from Shutterstock.com

Why should consumers be cautious of door-to-door solicitors?

HEALTH AND MEDICAL PRODUCT FRAUDS

A common gimmick involves deceptive advertising for expensive "miracle" pills, creams, or devices to enhance health and beauty. Magazines, newspapers, websites, e-mails, and flashy

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

tabloids often carry these types of advertisements. People often give fake endorsements claiming they were "cured" or lost vast amounts of weight with no effort. The product may be totally ineffective.

INFOMERCIALS

infomercial a lengthy paid TV ad that includes testimonials, demonstrations, and introductory prices

An **infomercial** is a lengthy paid TV ad that includes testimonials, demonstrations, and introductory prices. Fitness and weight loss, hair growth, cosmetics, and kitchen gadgets are common subjects of infomercials. Some of the product claims are genuine, but many do not deliver on the promises made. Infomercials often contain gimmicks such as an initial shipment at a reduced price, but in accepting the offer, you may have signed up for six more shipments or some other hidden commitment.

CHECKPOINT ▸ ▸ ▸

How is a Ponzi scheme similar to a pyramid scheme?

How Can Consumers Protect Themselves from Fraud?

Being a responsible consumer means looking out for yourself before you make a bad decision. Prevention is your best protection. To protect yourself, be alert to the warning signs of a scam. Educate yourself on products and prices, and seek remedies when necessary.

IDENTIFY DECEPTIVE PRACTICES

When you hear unrealistic claims, be suspicious. Watch for warning signals in claims or offers made through advertising and by salespeople. Figure 3-4.1 lists common warning signals of possible fraud and deception.

Figure 3-4.1 Warning Signs of Fraud

Watch out when you hear this:

- You can get something for nothing.
- You can buy a high-quality product for an incredibly low price.
- To receive a prize or "free" product or service, you must supply your credit card or checking account number or pay a high shipping fee.
- You will receive a free gift if you act now.
- You or your home has been specially selected.
- You can attend a demonstration with no obligation to buy.
- If you don't decide right now, you will lose the opportunity.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

SHOP SMART

In a market economy, there are many products and services from which to choose. Many products are complex, and the methods used to sell them are misleading. Internet shopping has added new dangers as well. To make good buying decisions, consider these ideas:

- *Be aware of prices*. Know regular or "list" prices of common items. Learn the meaning of "manufacturer's suggested retail price" (MSRP), which is commonly used in ads. MSRP is the price recommended by the manufacturer. Most stores sell at or below this price.
- *Understand sale terminology*. *Sale* means that goods are offered for sale, but not necessarily at a reduced price. *Clearance sale* means the business wants to clear out the advertised merchandise, but again, it may not be at a reduced price. *Liquidation* means the business wants to sell everything right away, but not necessarily at reduced prices.
- *Compute unit prices*. *Unit pricing* is the cost for one unit of an item sold in packages of more than one unit. The lowest unit price for products of comparable quality is the best buy. Figure 3-4.2 shows how to compute unit prices.
- *Read labels*. Know ingredients and materials and what they mean. For example, a shirt that is 100 percent cotton will probably shrink. A product that is "dry clean only" will be expensive to maintain.
- *Check packages carefully*. Be sure packages have not been opened or damaged. Report suspicious package openings, especially of health-related products.
- *Read contracts*. Read and understand contracts before you sign.
- *Keep receipts and warranties*. For all major purchases, keep receipts and warranties for possible use later. A *warranty* is a statement guaranteeing the quality and performance of a product or service. Print out and keep warranty statements and sales receipts from online purchases as well.
- *Compute total cost*. Check the total cost of an item, including supplementary items (such as batteries), shipping and handling charges, finance charges, and other add-ons.
- *Research businesses*. Check for certifications, licenses, bonding, and other qualifications. Use the BBB and your state licensing divisions to verify qualifications. Research websites before you place an order.

Figure 3-4.2 Computing Unit Prices

The formula for computing unit prices is:

Price of the item ÷ Number of units per measure

The unit costs of a 15-ounce box of cereal that sells for $1.89 and a 24-ounce box of cereal that sells for $2.59 are computed as follows:

$1.89 ÷ 15 ounces = $0.126 per ounce

$2.59 ÷ 24 ounces = $0.108 per ounce

The 24-ounce container is the better buy, if you will use all 24 ounces.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

STAY INFORMED

You are responsible for educating yourself about products and services before you buy. Actively seek information from publications such as *Consumer Reports*. Analyze advertisements and assess your needs. Be wary of emotional appeals that are probably too good to be true. Ask lots of questions, verify, and follow through. To avoid being a victim, visit consumer protection websites often to stay informed of the latest scams. When you discover fraudulent practices, report them to consumer protection agencies to help keep others informed.

SEEK REDRESS

When you have a complaint or need to solve a problem, you have the right to seek *redress,* or a remedy to the problem. Most businesses will work with you to resolve a problem. Using good communication skills can help you resolve complaints quickly. In addition, follow the steps listed below.

1. *Take the product back to the store where you bought it*. Calmly explain the problem in detail and provide evidence. You may need to ask to see the manager. If you bought online, call customer service. Have copies of relevant information to support your position.
2. *Stay firm but not angry.* Say you are dissatisfied and explain why. Ask for the redress you want (refund, replacement, repair, and so forth). Be reasonable.
3. *Put your complaint in writing.* If you are not satisfied with the manager's remedy, put your complaint in writing to the store's headquarters or owner. If you still are not satisfied, write to the manufacturer or distributor of the product and state your complaint. Again, be specific about what you want. Specify a reasonable time period for resolution of the problem.
4. *Send copies of evidence, such as sales receipts, warranties, previous correspondence, and anything else that will support your position.* Keep copies of your correspondence and notes about whom you talked to and what was said along with dates and any actions taken or promised.
5. *File with consumer protection agencies*. If you are still dissatisfied with the result, file a complaint with the appropriate consumer protection agency. There may be more than one agency that can assist you. Provide the agency with a full description and copies of your documentation.
6. *As a last resort, seek legal recourse*. Attorney's fees are expensive, so it is better to resolve the issue yourself if possible. Small claims court or other legal remedies may be a less-expensive choice. Know what you want and be prepared to negotiate and compromise if the remedy offered is fair.

When should you seek legal recourse as a way to resolve a problem?

CHECKPOINT ▸ ▸ ▸

How can you detect deceptive selling practices?

©Rafa Irusta, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3-4 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Information on products advising consumers about risks and safety issues

____ 2. False claims about a product

____ 3. Copying the contents from one form of media to another for personal use

____ 4. A lengthy paid TV ad that includes testimonials, demonstrations, and introductory prices

____ 5. Recording video or audio for later viewing or listening

____ 6. Advertising a basic service at an unusually low price and then claiming additional services or repairs are needed

a. bait and switch
b. deception
c. infomercial
d. low-balling
e. pigeon drop
f. Ponzi scheme
g. pyramid scheme
h. space-shifting
i. time-shifting
j. warning label

____ 7. A fraudulent investment operation in which money from new investors is used to pay off earlier investors

____ 8. Advertising a bargain product with the intent of persuading consumers to buy a more expensive product once in the store

____ 9. Illegal multilevel marketing gimmick that promises commissions on one's own sales as well as on the sales of recruits

CHECK YOUR UNDERSTANDING

10. List three important laws that define consumer rights.
11. What is contained in the Airline Passenger Rights?
12. List five consumer protection laws.
13. How do warning labels protect consumers?
14. What information must be included on care labels?
15. What is the purpose of FERPA? HIPAA?
16. List three federal agencies that provide consumer protection services.
17. What does the SEC do to protect consumers?
18. List five methods of defrauding consumers.
19. Explain how infomercials can be misleading for consumers.
20. List four things you can do to protect yourself from fraud.
21. List five ways you can shop smart (to avoid fraud).
22. List the six steps to follow when seeking redress.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

23. If you were writing a new law to protect consumers, what would you include?
24. Technology today gives consumers the ability to download songs and other literary work without paying for them. This deprives the artist of royalties. Sales of CDs and DVDs have dropped dramatically. Do you think there should be some tighter controls on downloading, including laws that provide for criminal penalties? Why or why not?
25. Small private airplane crashes have increased significantly. In a recent year, the FAA announced that it would increase regulations of small aircraft. Do you agree that increased regulations are needed? Why or why not?
26. All food and drink must be labeled as to content and nutrition value, including the amount of calories, fat, and salt. Why is it important for consumers to have this information?
27. The FDA lifted its advertising ban on pharmaceutical companies and allowed them to market directly to consumers. Since then, targeted ads have appeared on television, and drug sales have soared. Do you think it was a good idea to lift the ban? Why or why not?
28. Why is it necessary for the FCC to regulate communications? Visit the FCC online and explain the agency's mission. Do you think this agency is adding value for consumers?

EXTEND YOUR LEARNING

29. Copy the ingredients or contents from the labels of the following products: deodorant, breakfast cereal, liquid cleaning product, and bug spray. Do any of the labels carry warnings? What types of precautions are suggested? Why is it important for consumers to be informed of product ingredients or contents?
30. Visit the ConsumerReports.org website or obtain an issue of *Consumer Reports* from your library and answer these questions:
    a. Who publishes this magazine?
    b. Who advertises in the magazine?
    c. How are products tested and compared for safety and/or quality?
    d. Select a tested product. What three key findings about this product would influence your buying decision?
31. Assume you bought a new GPS navigation device at a store last week. It froze up while you were using it, and you were unable to reset it. Because the screen wouldn't turn off, the battery ran down and you replaced it. Now the device won't turn on again. You went back to the store for help, but the manager told you to contact the manufacturer. Because the device was part of a clearance sale, it was sold "as is." Write a letter of complaint. For purposes of this assignment, create information about the manufacturer, the receipt, and the warranty to include in your letter. Specify the redress you are seeking.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

EDUCATION

Do you like to work with people? Are you good at explaining concepts and tasks? If the answer is yes, a career in education might be right for you. Jobs in education involve teaching children and adults. Some workers in this field, such as a school principal, handle administrative tasks. Others, such as counselors, provide support services related to education. Child care workers provide care for children who have not yet entered school and also work with older children before and after school hours.

Jobs in education are found in public and private schools. Teachers receive the education and training to be able to help others learn. They often teach numerous subjects every day. They put in extra hours meeting with parents and grading homework and exams.

Employment Outlook

- Employment opportunities are expected to grow faster than average as retired workers leave the field.

Job Titles

- Teacher/Instructor
- Teacher's aide
- Principal
- Counselor/Adviser
- Administrator

Needed Education/Skills

- Bachelor's degree in the field you will teach, such as English or elementary education
- Master's degree (or higher) for advancement and tenure positions
- Excellent communication skills, good problem-solving skills, and the ability to work well with others

What's it like to work in . . . Education

Rich arrives by 7:05 a.m. each morning and prepares for his day in the classroom. He will teach four class periods, then have lunch, and then teach two more classes. After that, he will coach the swim team for another two hours.

This week, Rich is preparing for parent-teacher conferences for his high school students. He is expecting parents to have questions and concerns, and he will make recommendations for how they can support their children's efforts. He keeps very good records.

His day begins with a history lesson for 24 high school sophomores. He will teach two geography classes as well, and then another history class before noon. Teaching takes a lot of energy and enthusiasm. He cares about his students and wants them to learn what they need to know to succeed. He is passionate about the subjects he teaches and is eager to share his knowledge.

What About You?

Would you enjoy teaching others a subject that you know well? Do you like making presentations and holding others' attention? Do you have excellent communication skills?

©Gelpi, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 3 Assessment

SUMMARY

3-1 Inflation is the increase in general price levels for goods and services and is measured by the Consumer Price Index. Inflation reduces purchasing power.

Patterns in changing price levels include disinflation, reflation, hyper-inflation, and deflation. Inflation may also be categorized by its cause: demand-pull inflation, cost-push inflation, and real-cost inflation.

There is a direct connection between inflation and employment. Higher inflation usually means more people are employed.

3-2 Four methods of setting prices in a market economy include cost-recovery pricing, cost-plus pricing, value-based pricing, and market-based pricing.

Rational buying strategies include economizing and optimizing. When used wisely, these strategies help keep prices low. Overspending caused by impulse and emotional buying contributes to inflation.

3-3 Selling strategies used by businesses include making shopping convenient, providing good customer service, and offering products and services to meet consumers' demand. To create demand, businesses use advertising in its many forms.

To maximize their purchasing power, consumers should use buying strategies before shopping, during shopping, and after shopping. One important buying strategy is comparison shopping.

3-4 Laws defining consumer rights include the Consumer Bill of Rights, Airline Passenger Rights, Consumer Technology Bill of Rights, and the Patients' Bill of Rights.

Consumer protection laws are in the area of food, medicine, and medical devices; hazardous substances; drugs; labeling and advertising; traffic and motor vehicle safety; care labeling; nutrition labeling; and privacy.

There are numerous federal agencies that may be contacted for assistance with consumer problems, including the USDA, FDA, CPSC, FCC, FTC, FAA, and SEC. Private organizations such as the BBB, MACAP, NCL, and CU also provide assistance and/or information for consumers.

There are many forms of fraud, including bait and switch, fake sales, low-balling, pyramid schemes, Ponzi schemes, pigeon drops, fraudulent representation, health and medical product frauds, and infomercials.

Consumers can protect themselves by identifying deceptive practices, shopping smart, staying informed, and seeking redress.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Complete these problems to build your math skills. You may use spreadsheet software or complete the problems manually.
   a. Comparing unit prices can help a consumer determine which size or package of a product is the best value. To find the unit price of a product, divide the total price by the number of units. Find the unit prices for the following items. Round to three decimal places.
      Product A: $3.96 for 24 ounces
      Product B: $2.99 for a 16-ounce box
      Product C $3.69 for 12 cookies
      Product D $4.99 for 6 muffins
      Product E $12.99 for 5 pounds
      Product F $25.00 for a case of 36
   b. Determine which of these items has the lowest per-unit cost and, thus, is the best buy.

Product A:	$1.99 for a 6-ounce bag	or	$2.49 for an 8-ounce bag
Product B:	$24.00 for a box of 10	or	$36.00 for a box of 15
Product C:	$6.99 for 3 pounds	or	$8.99 for 5 pounds

   c. The price of gasoline rose from $2.50 on March 1 to $2.89 on March 31. By what percent did the price increase?
   d. The price of an air conditioner fell from $250 on August 1 to $200 on October 1. By what percent did the price decrease?
   e. A retailer bought a product for $22 and sold it for $36. What is the amount of the markup? What is the percent of markup?
   f. You plan to loan $1,000 to a neighbor for 6 months. You realize that the value of a dollar may be less 6 months from now than it is today. You want to charge enough interest so that the money your neighbor repays you will have the same purchasing power as the money you loan. The inflation rate for the next year is predicted to be 5 percent. How much interest (in dollars) should you charge on the loan to maintain the purchasing power of your money?
2. **Ethics** When a salesperson works for commissions, he or she may earn no income unless a sale is made. Sometimes, this results in pressuring customers to make purchases they do not really need or want. Some customers are unable to resist this sales strategy.
   a. Have you ever bought something that you later felt you had been pressured into buying? How satisfied were you with that purchase?
   b. What will you do differently the next time you are faced with this situation?
   c. Ethically speaking, what is wrong with pressuring someone to buy when she or he is not ready or does not really need or want the item?
3. **Social Studies** Prepare a presentation to explain the role of government in consumer protection and its importance. Use visual examples to explain the benefits of governmental consumer protection.
4. **Communication** Write a paper declaring a bill of rights in an area that concerns you. What rights would you like to have guaranteed to you as a citizen? As you outline your rights, be specific.
5. **International Studies** Select another country and research its consumer protection laws. How are they different from U.S. laws?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6. **Research** Perform research to find a recent news story about a business that used deceptive marketing practices, such as bait and switch, fake sales, low-balling, pyramid schemes, Ponzi schemes, pigeon drops, and other gimmicks. Present the deceptive practices and the final outcome to the class. Create a list of tips on how to avoid becoming a victim of these fraudulent practices and share it with your classmates.
7. **Economics** Conduct Internet research about how prices are set in the market economy. Explain the concept of the "invisible hand" of the market and how consumer behavior plays a significant role in what is produced, for whom, and at what price. Prepare a two-page report or a PowerPoint presentation of your findings.
8. **Communication** When shopping, it is important to be able to communicate your needs to the salesperson or merchant. Think of a product or service you would like to buy. Then write a script of the conversation between you and the salesperson who is trying to sell you the product or service. Be sure you describe the product or service features that will meet your needs.

Take Action

RESEARCH AND REPORT

Working with a partner, visit the websites listed below, plus another website of your choice. As described below, write a short report based on what you learn at each website. Print a copy of the home page for each website and include it with your report.

a. Visit the USDA (www.usda.gov) or FTC (www.ftc.gov) website. Locate a news article that interests you. Write a one page bulleted list of the most important consumer information facts in the article.

b. Visit the Securities and Exchange Commission's website (www.sec.gov). Follow the link to Laws and Regulations. Select one law or regulation and summarize how it protects investors.

c. Go to the Better Business Bureau's website (www.bbb.org) and look up reports on two local companies. Write a summary of the kinds of information the reports provide about the companies.

d. Visit the National Consumer League's Fraud Center (www.fraud.org) and answer the following questions:
   - What services are available to consumers who have complaints?
   - What is the process of registering a complaint?

e. Visit your state's attorney general's office or the consumer protection division of your state's Department of Justice. Summarize the information available to consumers and the process for filing a complaint.

After completing this project, save your reports and include them in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 4

Financial Decisions and Planning

4-1 Resources and Choices

4-2 Basics of Budgeting

4-3 Personal Financial Planning

©Monkey Business Images, 2010/Used under license from Shutterstock.com

Good money management begins with taking a careful look at your needs and wants. In this chapter, you will learn how your financial resources impact your choices. You will look at where you are now financially and prepare a personal net worth statement. You will study strategies you can use to make better financial choices. You will then explore budgeting and create a simple budget. You will learn about budget variances and how to keep good financial records. Finally, you will examine a five-step financial planning process, which begins with setting your personal and financial goals.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Key Terms Flashcards
Flash Game
Chapter 4 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-1 Resources and Choices

GOALS

- Describe needs and wants and explain how financial resources help fulfill needs and wants.
- Prepare a personal cash flow statement and a personal net worth statement.
- Apply a decision-making process to personal financial choices.

KEY TERMS

- needs, p. 118
- wants, p. 118
- financial resources, p. 118
- cash inflows, p. 119
- cash outflows, p. 119
- assets, p. 119
- liabilities, p. 119
- net worth, p. 119
- tradeoff, p. 121
- opportunity cost, p. 121

What Are Needs and Wants?

needs things needed for survival, such as food, clothing, shelter, and medical care

wants things people desire for reasons beyond survival and basic comfort

Needs are things you must have for survival, including food, clothing, shelter, and medical care. Beyond these basic needs, people may have o*ther needs* to fulfill in order to lead a comfortable lifestyle. Other needs could include things such as more than one pair of shoes, clothing for different purposes, an education, and furniture. **Wants** refer to things people desire for reasons beyond survival and basic comfort. These items allow people to enjoy life more. Examples of wants include new cars, vacations, a large wardrobe, dozens of pairs of shoes, and so on. *Luxury items*, which are very costly, often fill emotional wants rather than physical needs.

RESOURCES LIMIT CHOICES

financial resources money or other items of value that are used to acquire goods and services

Financial resources include money or other items of value that people can use to acquire goods and services. Although people's financial resources are limited, their wants and needs are unlimited and growing. Every day, new products and services are introduced on the market to tempt consumers. Because most people do not have enough resources to meet all their needs and wants, they must make choices.

©Tyler Olson, 2010/Used under license from Shutterstock.com

What needs are represented in this photo? Wants?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

For a person who has few resources, the choices available will also be few. This person may need to spend all resources to cover basic and other needs. For a person with more resources, more choices will be available. The amount of money a person has to spend after needs are met is called *discretionary income*. People who have high discretionary income can consider buying luxury items they may want.

CHECKPOINT ▸ ▸ ▸

How are your wants and needs related to your financial resources?

How Are Income and Wealth Measured?

Your income can be measured using a cash flow statement. Your *wealth*, or items of value minus any debts owed against those items, can be measured using the personal net worth statement. By preparing these forms on a regular basis, such as once a month or year, you will be able to see how your wealth is growing (or shrinking) over time.

THE PERSONAL CASH FLOW STATEMENT

The *personal cash flow statement* lists your cash inflows and cash outflows for a period of time. **Cash inflows** include income you receive from your job, investments, and other sources. You can spend this amount of money without using savings.

cash inflows income from your job, investments, and other sources

Cash outflows are expenses, or items for which you must spend money. Most people have regular expenses to meet. Some expenses are easy to predict. Others happen unexpectedly, such as the cost of replacing a blown tire. It is wise to make saving a planned expense. In order to save, you will need to spend less than you receive in income. Saving increases your wealth.

cash outflows expenses, or items for which you must spend money

If your cash inflows exceed your cash outflows, you have a positive cash flow, or *net income*, for the period. If your cash outflows exceed your cash inflows, you have a negative cash flow, or *net loss*, for the period. Comparing monthly cash flow statements over time can help you see whether you are meeting your financial goals. As an example, the personal cash flow statement for Andrea McCall is shown in Figure 4-1.1. She has a positive cash flow of $22.

THE PERSONAL NET WORTH STATEMENT

A *personal net worth statement* shows a person's net worth based on his or her assets and liabilities. **Assets** are money and items of value that you own. For certain assets, such as a car, their value is the price you could get if you sold them. Debts that you owe are called **liabilities**. The amount owed on a car loan is a liability. The difference between your assets (what you own) and your liabilities (what you owe) is called **net worth**. As an example, the net worth statement for Jerry Perez is shown in Figure 4-1.2. It indicates that he has net worth of $3,351.58 as of May 1, determined as follows: $4,652.56 (total assets) – $1,300.98 (total liabilities) = $3,351.58 (net worth).

assets money and items of value that you own

liabilities debts that you owe

net worth the difference between your assets and your liabilities

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 4-1.1 Personal Cash Flow Statement

ANDREA MCCALL
PERSONAL CASH FLOW STATEMENT
April 1–30, 20--

Cash Inflows		
Work (part-time)	$120.00	
Allowance for household chores	40.00	
Lunch money allowance	60.00	
Savings account interest	2.00	
Total cash inflows		$222.00
Cash Outflows		
Gifts	$ 20.00	
Clothes and shoes	60.00	
Loan payment to parents	20.00	
Lunches	60.00	
Entertainment/miscellaneous	40.00	
Total cash outflows		200.00
Net cash flow		$ 22.00

Figure 4-1.2 Personal Net Worth Statement

JERRY PEREZ
PERSONAL NET WORTH STATEMENT
May 1, 20--

Assets		**Liabilities**	
Cash and checking account	$ 452.56	Car loan	$1,100.00
Savings account	500.00	Credit card debt	200.98
Savings bonds	300.00	**Total liabilities**	$1,300.98
Baseball card collection	100.00		
Computer, iPod, games	300.00	**Net Worth**	
Car, current value	3,000.00	Assets minus liabilities	3,351.58
Total assets	$4,652.56	**Total liabilities and net worth**	$4,652.56

Net Worth

Assets that are growing in value are said to be *appreciating*. The value of savings bonds, for example, will grow over time. The value of land or a house may also increase over time. Other assets, such as cars and electronic items, may be *depreciating*, or decreasing in value. These items have temporary value that will be used up over time.

CHECKPOINT ▸ ▸ ▸

What is the purpose of a personal cash flow statement?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

READING VOCABULARY

Reading is a basic communications skill. Much of the information you need comes in written form. You read for many reasons, such as to learn new ideas related to school, work, or personal activities. You read directions for completing a task or following a particular route. You also read stories, novels, or poems for pleasure.

Your *vocabulary* is made up of the words you know and understand how to use. Whatever your purpose in reading, improving your vocabulary will help you better understand the material you read. For example, key terms are listed in each chapter of this textbook. Learning these words will help you understand the concepts presented. Use the following strategies to add new words to your vocabulary:

- Try to learn the meaning of a word from the way it is used in a sentence. Then check a dictionary to see if that meaning is correct.
- Divide a long word into parts. If you know the meaning of one part, you may be able to guess the meaning of the entire word. Again, check a dictionary to see if that meaning is correct.
- When you are reading and see a word you do not know, find the meaning in a dictionary at that time, if possible. If you cannot check the dictionary right away, make a note of the word and find it in a dictionary later.
- If you find a word you do not know when reading a textbook, see if the word is defined in a glossary at the end of the book.
- Practice using new words in conversation or in writing to help you remember their meanings.

Try It Out

Read a newspaper or magazine article about money management. Highlight any words that are new to you. Did you learn their meaning from the article? If not, look up the definition for those words you still do not know. Then read the passage again. Describe what you learned from reading the article.

How Can You Make Good Financial Choices?

Buying decisions play an important part in managing your money. When you give up one option in exchange for another that you think is more desirable, you are making a **tradeoff**. For example, you may choose to use your money to buy an iPod® instead of a bicycle. The tradeoff results in an **opportunity cost**, which is the value of your next best option—what you are giving up. For example, in buying the iPod, the opportunity cost is the value of the bicycle. Value can be measured in many ways, such as in dollars, time, convenience, enjoyment, and so forth.

tradeoff giving up one option in exchange for another

opportunity cost the value of your next best option—what you are giving up

DECISION-MAKING PROCESS

To help you make good financial decisions, use a step-by-step decision-making process.

1. *Define the need.* Determine what need will be filled or problem resolved by buying the item or service. For example, you might need a computer to do online research and to complete homework. Think about all the ways in which the item or service could be used and the features it should have to meet your needs.
2. *List options for meeting the need.* You could buy a new computer or borrow use of a computer at the local library or school lab. List the cost of each option. Research the features of any items you consider buying.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3. *Compare the options you have identified.* List the advantages and disadvantages of each one. Also, think about the opportunity cost of each option. For example, using a computer at the library would be less costly than buying a computer. What are the opportunity costs of choosing this option? You would have to travel to the library each time you wanted to use the computer and could use it only during the hours the library is open. Thus, the opportunity cost, or the value of your next best option, would be the convenience of owning your own computer. You must decide which you value most—convenience or saving money.
4. *Make a decision.* Based on your research and evaluation of the information you have gathered, choose the option that is best for you.
5. *Take action based on your decision.* For example, buy a computer or plan times to use one at the library.
6. *Reevaluate your choice.* After some time has passed, think about your decision again. Did the option you chose resolve the problem or fill the need for which it was selected? If the answer is no, or if your needs have changed, follow the process again to make a new decision.

FINANCIAL STRATEGIES

Financial choices you make today will affect your finances tomorrow. If you plan ahead, you will be better prepared to use your resources to meet your needs and wants. Making good financial choices will help prevent worry over financial matters. Follow these strategies to make better financial choices:

- Financial choices should be forward-looking. Ask yourself how a choice will affect your future.
- Consider the opportunity cost (the value of what you give up) each time you make a purchase. Doing so will help you decide whether the item or service selected is the best choice for you.
- When in doubt about whether to buy a particular item or service, do not make the purchase. If you are not sure of a choice, keep asking questions or doing research until you know enough to make a good decision.
- Do not make snap decisions about financial matters. *Buyer's remorse* occurs when you make a purchase and then later regret it.
- Spend less than your income each month. Set aside money for unexpected expenses.
- Be realistic when deciding which wants you can fill. Learn to enjoy the items you have rather than always wanting more items.
- Take enough time to read all financial agreements. Ask questions to be sure you understand what you are agreeing to before signing a document.
- Learn from mistakes that others have made. Listening to the experiences of others can help you avoid the same financial problems.

CHECKPOINT ▸ ▸ ▸

Why is it important to compare options before buying?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Expenses, or items for which you must spend money

____ 2. Income from your job, investments, and other sources

____ 3. The act of giving up one option in exchange for another

____ 4. The value of your next best option

____ 5. Money or other items of value that are used to acquire goods and services

____ 6. Items of value that you own

____ 7. Things people desire for reasons beyond survival and basic comfort

____ 8. The difference between your assets and your liabilities

____ 9. Items needed to survive, such as food, clothing, shelter, and medical care

a. assets
b. cash inflows
c. cash outflows
d. financial resources
e. liabilities
f. needs
g. net worth
h. opportunity cost
i. tradeoff
j. wants

CHECK YOUR UNDERSTANDING

10. Besides food, clothing, shelter, and medical care, what are some other *needs* that a person might have?
11. How are wants different from needs? What are some wants that you have?
12. How do financial resources limit a person's spending choices?
13. What are liabilities? Give two examples.
14. How is your net worth calculated?
15. Explain how income is different from wealth.
16. How is net cash flow calculated?
17. What is the value of comparing monthly cash flow and net worth statements over time?
18. Explain how pay raises and promotions can help you increase your wealth as well as your income.
19. List the six steps for making good financial decisions.
20. List some strategies you can use to make good financial choices.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Many people confuse wants and needs. Make a list of items that are often considered necessities today but were considered luxuries or were nonexistent in your great grandparents' time. Explain how these items have increased our standard of living.
22. Financial resources include items such as checking and savings accounts, investments, and other items that can be used to cover your needs and wants. How can you add to and grow your financial resources? Why is it important to plan to do this during your lifetime?
23. What is contained in a personal cash flow statement? Why is it important for individuals and families to prepare a personal cash flow statement?
24. What is contained in a personal net worth statement? Why is it important for individuals and families to prepare a personal net worth statement?
25. Give an example of an asset that appreciates, or increases in value over time. Give an example of an asset that depreciates, or decreases in value over time. Why do some assets increase while others decrease? Which is the better investment?
26. Think of a recent purchase you have made. What was the tradeoff and opportunity cost involved in this purchase? Does every purchase decision have an opportunity cost? Explain your answer.

EXTEND YOUR LEARNING

27. Identifying the income, expenses, assets, and liabilities you have now is a good place to begin planning for your financial future. Create a personal cash flow statement and a personal net worth statement following these steps:
    a. Review the personal cash flow statement shown in Figure 4-1.1. Create a similar document using your information. Use spreadsheet software, if available, to create the statement.
        - List all your cash inflows—income you receive from any source during one month.
        - List all your cash outflows—expenses you pay during the same month.
        - Find the total of your cash inflows and cash outflows. Subtract the two total amounts to find your cash flow. Is it positive or negative?
    b. Review the personal net worth statement shown in Figure 4-1.2. Create a similar document using your information. Use spreadsheet software, if available, to create the statement.
        - List all your assets—money you have or things of value you own.
        - List all your liabilities—money you owe that must be repaid. (Note: For each, list the total owed and not the monthly payment.)
        - Subtract your liabilities from your assets to find your net worth. Note that if your liabilities are larger than your assets, you will have a negative net worth.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-2 Basics of Budgeting

GOALS

- Identify the purpose of a personal budget.
- Prepare a personal budget.
- Describe recordkeeping methods used in the budgeting process.

KEY TERMS

- budget, p. 125
- spreadsheet software, p. 125
- variable expenses, p. 128
- fixed expenses, p. 128
- charitable giving, p. 128
- variances, p. 129
- manual records, p. 130
- electronic records, p. 131
- encryption, p. 131

What Is the Purpose of Budgeting?

Budgeting is a critical part of managing your money. The purpose of a budget is to plan how you will spend and/or save money. A **budget** is a spending and saving plan based on expected income and expenses. A budget is similar to a cash flow statement because both are used to record income (cash inflows) and expenses (cash outflows). However, a cash flow statement differs because it lists *actual* cash inflows and outflows to show how much money you have available on a certain date. A budget lists *estimated* income and expenses to help you create a financial plan. Your goal is to create a financial plan that meets your daily and future spending and saving needs based on your expected income.

©Monkey Business Images, 2010/Used under license from Shutterstock.com

How can using a budget help you plan your spending?

You may need to adjust amounts in a budget several times. By using **spreadsheet software**, such as Microsoft® Excel®, you can insert numbers and formulas to compute amounts and then easily change them later as needed. For example, what if your expenses go up by 8 percent? How will the budget be affected? What if the price of a car you are saving to buy goes up by 10 percent during the time you are saving for it? How much money will you need for the car? Allowing you to answer "what if" questions easily is one of the strengths of a spreadsheet program. When you change a number in Excel that is part of a calculation, all other amounts affected are updated automatically. Because amounts are calculated using formulas, math errors are eliminated (assuming, you initially entered the formulas correctly).

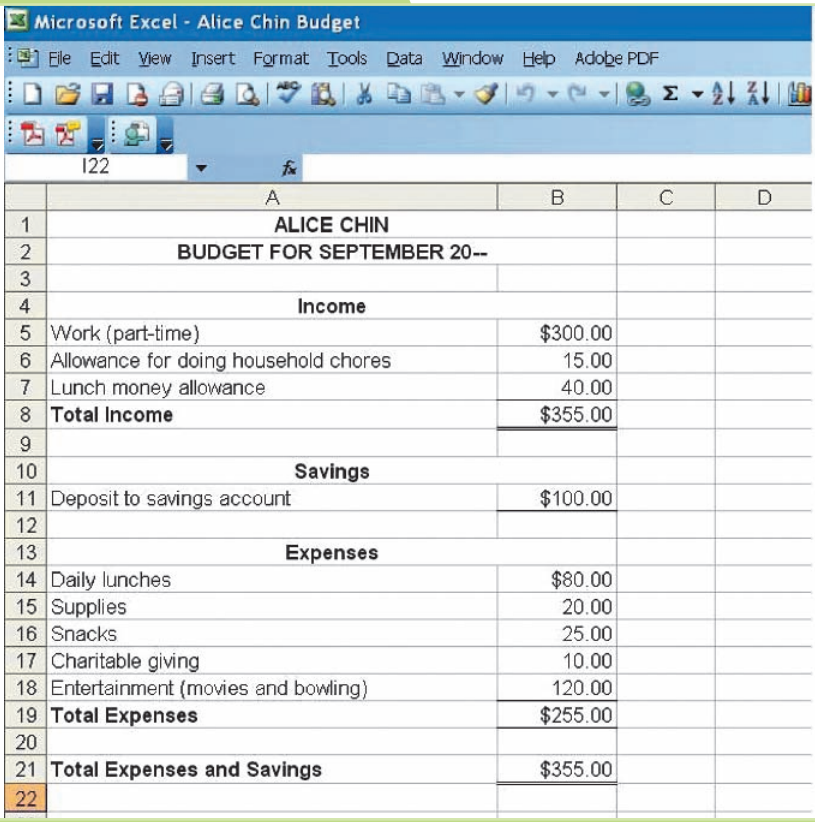
Using Excel, you can record your financial goals and then prepare the budgets that will help you achieve them. A sample budget created in Excel is shown in Figure 4-2.1.

budget a spending and saving plan based on expected income and expenses

spreadsheet software a computer program that allows you to insert numbers and formulas to compute amounts

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 4-2.1 Excel Spreadsheet



	A	B	C	D
1	**ALICE CHIN**			
2	**BUDGET FOR SEPTEMBER 20--**			
3				
4	**Income**			
5	Work (part-time)	$300.00		
6	Allowance for doing household chores	15.00		
7	Lunch money allowance	40.00		
8	**Total Income**	$355.00		
9				
10	**Savings**			
11	Deposit to savings account	$100.00		
12				
13	**Expenses**			
14	Daily lunches	$80.00		
15	Supplies	20.00		
16	Snacks	25.00		
17	Charitable giving	10.00		
18	Entertainment (movies and bowling)	120.00		
19	**Total Expenses**	$255.00		
20				
21	**Total Expenses and Savings**	$355.00		
22				

CHECKPOINT

How can you use a spreadsheet program to help you with budgeting?

How Do You Prepare a Budget?

A budget should be designed to help meet financial goals, such as paying for current expenses and saving for the future. To create a budget, begin by looking at the amount you have available to spend or save. Then decide how much of that amount you will save and how much you will spend. You must also choose the items or services for which you plan to spend. Remember that a budget is a plan. Your actual income, saving, and spending may not be exactly as planned. You can compare your actual spending and saving to the budget to see how well you planned. This process will help you create better budgets in the future.

Figure 4-2.2 shows a sample budget. Look at each part of the budget as you read the steps for creating a budget in the following sections.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 4-2.2 Personal Budget

ANDREA MCCALL
BUDGET FOR 20--

Income	Weekly	Monthly	Yearly
Work (part-time)	$30.00	$120.00	$1,440.00
Allowance for household chores	10.00	40.00	480.00
Lunch money allowance	15.00	60.00	720.00
Savings account interest	.50	2.00	24.00
Total income	$55.50	$222.00	$2,664.00
Savings			
Deposit to savings account	$ 5.50	$ 22.00	$ 264.00
Expenses			
Gifts	$ 5.00	$ 20.00	$ 240.00
Clothes and shoes	15.00	60.00	720.00
Loan payment to parents	5.00	20.00	240.00
Lunches	15.00	60.00	720.00
Entertainment/miscellaneous	10.00	40.00	480.00
Total expenses	$50.00	$200.00	$2,400.00
Total savings and expenses	$55.50	$222.00	$2,664.00

STEPS IN PREPARING A BUDGET

To prepare a personal budget, there are four simple steps. You should keep good records so that your budget is both realistic and accurate. This way, you can make better decisions about how to improve the way you spend your money.

Step 1 Estimate Income

You may have many different sources of *income*. Whether the money is earned or unearned, you should keep track of where it comes from and how often it is received. Because most budgets are prepared once a year, you should calculate income for an entire year. Locate the total estimated yearly income amount, $2,664.00, in the budget in Figure 4-2.2.

You may receive income weekly, monthly, yearly, or on some other schedule. No matter when the income is received, it can be accounted for in terms of a monthly or yearly budget. If you receive income weekly, multiply the weekly amount by 4 to calculate how much that is per month. For example, $10 received per week would be $40 a month. (Rounding is okay as long as your total yearly amount is accurate.) If you receive income once a month, you can multiply it by 12 to get yearly income. When you look at the big picture—how much money comes in and goes out during an entire year—it may change the way you think about money.

Step 2 Plan Savings

Pay yourself first—put money into savings before you consider other expenses. If you plan what you want to spend first, you may have no

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

money left for savings. Enter an amount that you would like to save. After entering expenses, you may need to adjust this amount. You might not be able to save as much as you want and still pay for all expenses. Plan to save some money, however, if at all possible. Savings allow you to plan for the future. You can identify items you would like to purchase at a future time with savings. Savings can also be used to pay for unexpected expenses that may come up. Locate the yearly savings amount, $264, in the budget in Figure 4-2.2.

Step 3 Estimate Expenses

Expenses are items for which you spend money. Clothes, lunches at school, and bus fares are examples of expenses. You may also make payments on an asset you purchase, such as a car. Other expenses are related to living costs and entertainment. Keeping track of what you spend will help you estimate expenses for the future. If you are trying to control expenses, seeing exactly how much you are currently spending for each expense can be helpful. Locate the expense amounts in the budget in Figure 4-2.2.

variable expenses costs that can go up and down each month

Costs that can go up and down each month are called **variable expenses**. An example of a variable expense is your gas and electric bill. When the weather is cold, the cost of heating your house will go up. Expenses can also vary due to changing prices. For example, as the price of gasoline rises, your transportation expense will also rise. The costs of food, clothing, and entertainment are also variable expenses. If you have less income or higher expenses than expected one month, you may need to decrease your variable expenses. You may choose to spend less on entertainment or take-out food. If you have more income or fewer expenses than expected one month, you might choose to spend more. For example, if you receive a gift of cash for your birthday, you can use the money to make an unplanned purchase, such as a new coat.

fixed expenses costs that do not change each month

Costs that do not change each month are called **fixed expenses**. Examples of fixed expenses are rent, insurance, and car payments. Renters typically have a lease contract stating a monthly rent amount that does not change for the term of the lease. Monthly car payments are usually fixed for the term of the car loan. Fixed expenses remain constant each month and must be paid even when income is less than expected. If income continues to be less than planned, a fixed expense may have to be eliminated. For example, if your income goes down because you lose your job, you may have to sell your car to eliminate the car payment you can no longer afford.

charitable giving the act of donating money or time to a cause in which you believe

Many people include charitable giving as a part of their monthly expenses. **Charitable giving** is the act of donating money or time to a cause in which you believe. You may donate through your church or a nonprofit organization. For example, you may donate money to the Red Cross to help earthquake victims.

Step 4 Balance the Budget

Find the total of savings and expenses in Figure 4-2.2. This amount should be the same as the total income amount. When these amounts are the same, the budget is in balance. If your savings plus your expenses exceed your income, adjust your budget to make them balance. To do this, you will have to lower your expenses, save a little less, or increase your income.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

PHILANTHROPY

After they have accumulated great wealth, some people give large sums of money to others. *Philanthropy* is a form of charitable giving that supports a societal cause, often over an extended period of time. *Philanthropists* want to leave the world a better place than they found it.

Philanthropy is the primary source of funding for the fine arts, the performing arts, and most religious and humanitarian causes. It also supports private (and some public) schools and universities. Many cultural institutions would not exist without the generosity of philanthropists.

Everyone has the opportunity to give something back. Many nonwealthy people also donate substantial amounts of time, effort, and personal resources to charitable causes. When you give of your time, you are in fact giving the most valuable thing you have. Time is something that cannot be stored and cannot be regained once it is gone. It is in very limited supply for each of us.

Philanthropy is said to feed the soul of the nation. When those whose needs are greatest are given a hand, the entire nation benefits. We are all able to enjoy the richness of culture that results from sponsored events.

Think Critically

1. Do online research to locate a charitable organization or foundation. Describe its purpose. How does it add value to society as a whole?
2. If you had the time and/or money, what charitable cause would you support? Why?

PREPARING A BUDGET ANALYSIS

A budget is a plan for saving and spending. You should not expect income, savings, and expenses to be exactly as you planned in a budget. The differences between planned amounts and actual amounts are called **variances**. Looking at the variances in your income and spending amounts can help you plan better when creating budgets in the future.

variances the differences between planned amounts and actual amounts

Sometimes you will earn or save more than you estimated. This is a *favorable variance*. If you earn or save less than you estimated, it is an *unfavorable variance*. The reverse is true with expenses. If you spend less money than you planned to spend, this is a favorable variance; if you spend more than you planned to spend, it is an unfavorable variance.

Figure 4-2.3 shows budget variances—both in dollar amounts and in percentages. To compute the percentages for income and savings amounts, subtract the budgeted amount from the actual amount; then divide the difference by the budgeted amount. To compute the percentages for expense amounts, subtract the actual amount from the budgeted amount; then divide the difference by the budgeted amount.

By looking carefully at variances, you can see where you spent more or less than the estimated amounts. Any variance that is more or less than 10 percent of what you had planned should be looked at carefully. For example, Andrea had planned to spend $60 on clothes and shoes for the month, but she actually spent $70. That is $10 more than budgeted, or a 17 percent difference. Andrea should think about why this happened. She may decide that she needs to revise the budget or change her spending habits. Analyzing variances will help you understand and better estimate your income and expenses.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 4-2.3 Budget Variances

ANDREA MCCALL
BUDGET VARIANCES FOR AUGUST

Income	Budgeted Amount	Actual Amount	Dollar Variance	Percent Variance
Work (part-time)	$120.00	$110.00	–$10.00	–8% U
Allowance for household chores	40.00	50.00	10.00	25% F
Lunch money allowance	60.00	60.00	0.00	0%
Savings account interest	2.00	2.00	0.00	0%
Total income	$222.00	$222.00	$ 0.00	0%
Savings				
Deposit to savings account	$ 22.00	$ 22.00	$ 0.00	0%
Expenses				
Gifts	$ 20.00	$ 18.00	$ 2.00	10% F
Clothes and shoes	60.00	70.00	–10.00	–17% U
Loan payment to parents	20.00	22.00	–2.00	–10% U
Lunches	60.00	55.00	5.00	8% F
Entertainment/miscellaneous	40.00	35.00	5.00	13% F
Total expenses	$200.00	$200.00	$ 0.00	0%
Total savings and expenses	$222.00	$222.00	$ 0.00	0%

CHECKPOINT

How can budget variances be used to plan better budgets?

What Are Recordkeeping Methods?

Keeping good records will help you prepare a better budget. Good information will also help you do a better job analyzing your budget. There are several methods you can use as you keep track of what you are earning, spending, saving, and investing.

MANUAL RECORDS

manual records information recorded using pen and paper

You can keep logs or journals on paper that list types and amounts of income, savings, and expenses. **Manual records** consist of information recorded using pen and paper. You can manually compute your variances and make notations about what to change. You will want to keep these journals over time so you can compare them from year to year. It is important to keep these records in a safe and secure place. This will protect them from fire and other forms of damage. And just as important, it will keep them safe from misuse by others. Whether or not you keep all records manually, you can jot down your thoughts and make notations in *hard-copy* format, which you

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

DEALING WITH CONFLICT

Conflicts are bound to happen sooner or later. People you know will not be able to get along with each other. Maybe you will have a hard time working out a problem with another person. The ability to deal with conflict is an important personal skill—it will help you both in your personal life and in your work life.

When faced with a conflict, stop and take a ten-second time out. For those ten seconds, ask yourself, "What is happening here?" Listen rather than talk. Think about who is speaking and why that person is upset. Repeat a short summary of the problem or complaint to acknowledge that you understand the issue and confirm what you have heard.

If the person is upset or angry and not speaking rationally, suggest that you continue your talk later. This will give you and the other person time to think about the issue. Resume talking when you are both calm and can speak in a courteous manner.

Focus on the problem, not on the person. Be objective. Do not let your personal feelings—whether you like or dislike the person—cloud your judgment. Look for positive ways to address the issue. Be willing to compromise, when appropriate, to reach a solution that will be acceptable to all parties. The next time you must deal with conflict, practice these skills.

Think Critically

1. Describe a past situation where there was conflict. What did you learn from the experience?
2. How could you have handled the conflict differently?

can transfer to your permanent or electronic records later. These notations will be useful in explaining spending and other actions you have taken.

ELECTRONIC RECORDS

Many people prefer to keep **electronic records**, which consist of a *soft-copy* format of your financial information stored on your computer. The software package Quicken® is an example of an electronic recordkeeping program. The software will store the data and allow you to update and print reports. It will also allow you to reference financial information quickly.

electronic records soft-copy formats of your financial information stored on your computer

You can also use spreadsheet programs, such as Microsoft Excel, for data entry and budget analysis. The program will allow you to compute variances in dollar amounts as well as percentages. You can set up worksheets and link them together.

Like manual records, electronic records should be protected from unauthorized uses and users. Passwords and **encryption**, which is the process of converting data to a coded form, will help protect your information.

encryption process of converting data to a coded form

CHECKPOINT

Why is it important to safeguard your financial records?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions.

____ 1. Costs that do not change each month

____ 2. Soft-copy formats of your financial information stored on your computer

____ 3. Costs that can go up and down each month

____ 4. Information recorded using pen and paper

____ 5. A spending and saving plan based on expected income and expenses

____ 6. The differences between planned amounts and actual amounts

____ 7. A computer program that allows you to insert numbers and formulas to compute amounts

____ 8. Process of converting data to a coded form

____ 9. The act of donating money or time to a cause in which you believe

a. budget
b. charitable giving
c. electronic records
d. encryption
e. fixed expenses
f. manual records
g. spreadsheet software
h. variable expenses
i. variances

CHECK YOUR UNDERSTANDING

10. What is the purpose of a budget? What is included in a monthly budget?
11. How can you use a spreadsheet to help with budgeting?
12. What are the four steps in preparing a budget?
13. What is meant by "pay yourself first" in relation to preparing a budget?
14. How are variable expenses different from fixed expenses?
15. Why is it important that a budget be balanced? If your budget does not balance, what can you do to bring it into balance?
16. What is an unfavorable variance?
17. Why is philanthropy important in our society? What can you do to make a difference?
18. Why is a good recordkeeping system important?
19. Describe how you can keep financial records manually.
20. How can you protect your electronic records from unwanted invasions of privacy? How can you protect your manual records?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why is it important to prepare a personal budget? It is often said that the mere act of preparing a budget will change one's saving and spending habits. Explain why that would be the case.
22. Why should you plan to pay yourself first in the budgeting process? Explain why savings are important to you both now and in the future.
23. Why do some expenses go up and down each month? Give examples of items in your family budget that change on a regular basis. What can you do to keep these expenses from rising unexpectedly?
24. Why do some expenses remain the same each month? Give examples of fixed expenses in your family's budget. What can you do to reduce these expenses?
25. Why is it important to budget for charitable giving? How does it affect your budget? Is it a variable or a fixed expense?
26. In relation to budgeting, keeping good records is important. How do you plan to keep accurate and complete records of your earnings, spending, and saving?
27. Why is it important to prepare and analyze budget variances?

EXTEND YOUR LEARNING

28. Review the personal budget shown in Figure 4-2.2. Then create your own personal budget for one month by following the steps described below. You may want to refer back to the personal cash flow statement you created at the end of Lesson 4-1 to see the income (cash inflows) and expenses (cash outflows) you previously identified. If it is available, use spreadsheet software to create your budget.
    a. Record your expected income from all sources during the month.
    b. Record an amount you want to save for the month.
    c. Record all your estimated expenses for the month.
    d. Total the sections of the budget to see if the budget is in balance. If it is not, change the savings or expense amounts to make the budget balance.
    e. Once the budget has been prepared and balanced, write down what you learned about yourself and your proposed spending and saving habits. How will you change them?
    f. Review your expenses and categorize them as variable or fixed. Do you have more fixed expenses or variable expenses? How do the different types of expenses affect your budget?
    g. Keep good records for a month so you can compare your actual results to your budget. Compute the variance for each income and expense item. Analyze your budget and list ways you might change it.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-3 Personal Financial Planning

GOALS

- Explain the purpose and steps of financial planning.
- List reliable sources of financial advice.
- Describe ways you can protect your financial resources.

KEY TERMS

- financial plan, p. 134
- personal goals, p. 136
- financial goals, p. 136
- short-term goals, p. 136
- medium-term goals, p. 136
- long-term goals, p. 136
- timeline, p. 136
- benchmarks, p. 137
- financial planner, p. 138
- phishing, p. 140
- identity theft, p. 140

What Is Financial Planning?

financial plan a plan listing personal and financial goals along with steps and a timeline for reaching them

Financial planning is a formal process that involves looking carefully at your current financial situation and thinking about your future. It requires a long-term commitment. As part of the financial planning process, you will create a financial plan. A **financial plan** contains personal and financial goals you want to accomplish along with steps and a timeline for reaching these goals. Getting a college education, owning a car, and owning a home are examples of personal goals. For each personal goal, you will have a related financial goal. Paying for living expenses, tuition, books, and other related expenses while in college is a financial goal. Saving for a down payment on a house or a car and having a job that provides enough income to make monthly payments are financial goals.

A financial plan is more than a budget. Its purpose is to plan for earning, spending, saving, and investing that will allow you to achieve your personal goals in the present and the future. You must put your financial plan into action and monitor it periodically. At least once a year, you should review and update the plan. Your plan should contain details, but it should not be too complex to review and follow.

Some people create a plan by themselves because their finances are not complex enough to require assistance. Other people get advice from experts who can help manage resources and plan for retirement. Whether you do planning by yourself or get help, you will need to complete the five steps of financial planning.

STEP 1 GATHER INFORMATION

The first step in financial planning is gathering information. Everything related to your finances should be considered. The purpose of gathering information is to look at the state of your finances now—your starting point. The following list shows examples of *financial records*, or documents that are used to assess your finances. You may not have all the items listed at this time in your life. However, you can gather or prepare the first three items. Other items may become part of your plan later in life.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- personal cash flow statement
- personal net worth statement
- personal budget
- checkbook
- current bank statements
- investment account statements
- insurance policies
- current paycheck stub
- tax returns
- will
- trusts
- financial contracts for items purchased on credit
- any other legal documents related to your finances

At some point when you review your plan, you will need to think about how to finance your retirement. You may want to gather data about your medical history and the medical history of family members. This data may help you estimate your life span, which affects the amount of income you will need over your lifetime. For example, many people may live until age 85 or 90 and should plan how to meet financial needs through that age.

©Cheryl Casey, 2010/Used under license from Shutterstock.com

How can you get started with your own financial plan?

STEP 2 ANALYZE INFORMATION

Take a careful look at the documents and information you have gathered. Find out if any data are missing and take steps to get the data. Carefully look at each document and make notes about what you see. Review your personal cash flow statement to see what your current sources of income (cash inflows) are. Look at your expenses (cash outflows). Do you have enough income to pay for your expenses and save for the future? If not, try to find ways to increase income and decrease expenses.

Review your personal net worth statement. What are your assets? What liabilities do you have? What is your net worth? Review a current monthly or yearly budget. Look at the items for which you spend money. Is there a way you can spend less and save more to meet long-term goals?

As you review your financial plan each year, consider the following questions. Some of them may apply now. Others may not apply to you for a few years or for many years.

- *Is your income steadily growing over time?* If so, by what amount and percentage? For example, you may have $2,000 more in income this year than last year. This is a favorable trend that will help you reach your goals.
- *Is your net worth growing over time?* When you compare the current personal cash flow statement to previous ones, do you see growth? If so, by what amount and percentage?
- *How are your spending habits changing?* What types of things are you buying (needs versus wants), and what are your purchasing plans over time?
- *Who else depends on your income?* Do you have a spouse or children that will be affected by your financial plan? What will they contribute? What needs will they have?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- *What new goals do you need to add and plan for?* Do you need a plan to pay for a college education for your child? Is it time to plan for retirement? Does your will need to be updated to include a new grandchild?

STEP 3 SET GOALS

Two types of goals should be considered when creating a financial plan—personal goals and financial goals. **Personal goals** are the things you want to achieve in your life. Living in your own apartment, owning a car, and taking a two-week vacation are personal goals. Personal goals should be set first because your financial goals will be based on them.

personal goals things you want to achieve in your life

financial goals plans for how you will pay for your personal goals

short-term goals things you expect to achieve within one week to one year

Financial goals describe how you will pay for your personal goals. Financial goals may be short-term, medium-term, or long-term. **Short-term goals** are what you expect to achieve within one week to one year. A financial plan for the short term tells you on a week-to-week or month-to-month basis what you would like to achieve. Perhaps you would like to save $40 by the end of the month. Perhaps you want to add $200 to your savings account by the end of the year. Using monthly and yearly budgets can help you achieve short-term goals and save for long-term goals.

medium-term goals things you expect to achieve in the next two to five years

Medium-term goals are those you wish to achieve in the next two to five years. You may wish to save money for college or for a future purchase or need. You may want to increase your yearly income within three years. These goals take longer to achieve and also require more planning.

long-term goals things you expect to achieve more than five years from now

Short-term and medium-term goals are often stepping stones to long-term goals. **Long-term goals** typically include what you want to achieve more than five years from now. You may wish to save enough money to buy a car or go on an expensive vacation. You may want to repay loans for money you borrowed to complete college. When you begin working full time, you may contribute to a 401(k) to save money for your retirement.

Achieving long-term goals may require you to save money for a long time. Online financial calculators are available to help you determine the costs of achieving long-term goals. For example, they can calculate how much you should save yearly based on when you want to retire, or how much you should save monthly to pay for college tuition and expenses. Financial calculators can make planning easier.

As part of the goal-setting process, you may experience delayed gratification. Doing without an item you would like to buy now in order to save money to fulfill a medium-term or long-term goal is an example of *delayed gratification*. For instance, you may have a goal of saving $30 per month to help pay for your college education. This month, you would like to buy some music CDs. However, if you do so, you will not be able to make your savings goal. Doing without the CDs now in order to be able to pay for college later is an example of delayed gratification.

STEP 4 DEVELOP A TIMELINE AND BENCHMARKS

Goals must be measurable. Plan a timeline for putting your goals into action. A **timeline** is a visual display of how long it will take to achieve each phase of your plan. Before creating a timeline, be sure your goals are prioritized based on how soon you need or want to achieve them.

timeline a visual display of how long it will take to achieve each phase of a plan

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 4-3.1 Financial Plan (One Goal)

BILL FONG
FINANCIAL PLAN
Updated April 1, 20--

Net worth on April 1, 20--: $525.56

Personal Goal	Financial Goal	Benchmarks	Timeline
Live in my own house in the country.	Buy a house in the country.	1. Save money for a down payment ($12,000) • Set aside $200 per month • Open a separate account for money saved • Talk to a mortgage broker to get prepared 2. Get a job that provides enough income to make monthly payments	5 years Once per month April 8 (next week) Make an appointment for April 15 2 years

For each personal goal, there may be a financial goal you must first achieve. Financial goals can further be divided into parts or steps. For each step, consider how long it will take to complete. Then set a target date for completion.

In addition to establishing a timeline, goals should include **benchmarks**, which are standards against which progress is measured. Benchmarks may consist of steps or specific actions to take. As you hit each benchmark, you will be another step closer to achieving the overall plan. The record showing the goals you intend to accomplish with timelines and benchmarks is your financial plan. A sample financial plan for one goal is shown in Figure 4-3.1.

benchmarks standards against which progress is measured

STEP 5 IMPLEMENT AND EVALUATE THE PLAN

Once you have decided on your personal and financial goals, begin working toward achieving them. Check off the items on your timeline as they are completed. Set new benchmarks if you learn about other ways to meet your goals. Most importantly, take a look at your financial plan often. At least once each year, you should evaluate the financial plan and update or revise it as needed.

Your financial plan represents your personal and financial goals at one point in time. Those goals are likely to change over time. For example, you may inherit money, or you may have children. You may have a job opportunity overseas, or you may wish to spend more time on a hobby or a side business. As your personal and family goals change, your financial plan should be updated to reflect new goals.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

Why is financial planning important?

Where Can You Get Good Financial Advice?

There are many types and sources of financial advice. Some are better than others. Some may appear to be good, but ultimately you could lose your money. Choosing the right source of advice is important. When you seek outside advice, you should consult someone who is knowledgeable and has a proven track record.

FINANCIAL PLANNERS

financial planner a professional consultant who provides financial advice for a fee or commission

A **financial planner** is a professional consultant who provides financial advice to individuals for some type of fee or commission. A CFP (certified financial planner) has completed an educational program for providing financial planning services. Financial planners are also known as *financial advisers*. Financial planners help people develop financial plans to meet their financial goals. They review every aspect of their client's financial life, including savings, investments, insurance, taxes, and retirement.

Another type of financial planner is the *investment adviser*. The investment adviser may not delve as deeply into the client's financial life. They may only give advice on investing in stocks, bonds, and mutual funds (a professionally managed collection of stocks and bonds). Your bank or credit union may have investment advisers who can work with you.

In working with financial planners, you should be aware that they often make money from the investment products you purchase from them. Some financial planners work for a commission, meaning they are paid a percentage of the sale amount. To earn higher commissions, some planners might push the most expensive products instead of the products that best suit the needs of their clients. This is an unethical practice. For consumers, it can be difficult to tell whether or not they are buying the best product at the lowest price. To avoid this kind of dilemma, hire a financial planner who does not work on commission. Instead, pay for the financial advice separately from buying any financial products.

You will need to share personal information about your income, assets, liabilities, and net worth with your financial planner. As with any professional, the financial planner should keep your information confidential and should not use it for personal benefit. You must be able to trust the planner with your most sensitive personal data. Find out if the planner has been in business long, whether any complaints have been filed, and if he or she has a criminal background. Ask what measures the planner will take to keep your data secure. The time and energy you spend carefully selecting your financial planner will be well worth it.

FINANCIAL EXPERTS

A *financial expert* gives advice based on superior knowledge and experience. Many financial experts publish self-help materials in the form of

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

books, videos, and other media. You can purchase them at bookstores and online. You can also listen to financial experts on television, radio, or special news programs.

FINANCIAL SECTIONS AND ARTICLES

If you are willing to do some research, you can learn about almost any type of financial product you would consider including as part of your financial plan. Newspapers have financial sections that list stocks and securities. Newspapers and magazines also publish articles explaining how to make good financial choices.

Internet articles can also give you good information, but you must be careful of the source. Generally, websites ending in .edu, .gov, and .org are less likely to be biased, or to show a preference toward a certain product, than those ending in .com, .net, or .biz. Whenever a website is selling a product as well as providing information about it, you are more likely to get biased information.

SEMINARS AND WORKSHOPS

Companies that provide financial products such as mutual funds or retirement accounts often provide free seminars and workshops. These events will give you information about how products work. You can also get new investment ideas and learn how financial markets work. Be careful to avoid any sales pressure. Sometimes these events charge fees for attendance. Other times they are free, but you must listen to their entire presentation. Be sure to avoid giving personal information that could be used to defraud you.

©iofoto, 2010/Used under license from Shutterstock.com

Why might you want to attend a financial seminar?

FINANCIAL WEBSITES

There are many free websites on the Internet to help consumers get started with their financial planning. Most of these sites are legitimate and offer good advice. They do not charge for their services, and they are good resources for young adults starting out on their own. Many of these sites are sponsored by organizations or foundations that seek to help consumers do a better job of managing their assets. Others are available through mutual fund companies, government and educational programs, and other groups that offer free advice, information, and support. As always, avoid providing personal information over the Internet unless you are sure the website is authentic and secure.

CHECKPOINT ▸ ▸ ▸

How does an investment adviser differ from a financial planner?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NET Bookmark

The Federal Trade Commission provides information to consumers regarding identity theft. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 4. Answer the following questions: How can thieves use your trash to steal your identity? What are some things thieves do with a stolen identity? What are some things you can do to prevent identity theft?

www.cengage.com/school/pfinance/pfl

How Can You Protect Financial Resources?

You must protect your financial wealth. Deal only with financial advisers and financial institutions that you know and trust. Keep good records and verify account balances regularly. Guard your passwords. If you suspect your account or identity has been compromised, call or visit your bank or financial adviser. Keep your monthly statements in a safe place, such as a locked drawer, strongbox, or safe.

phishing a scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information

Be very careful when communicating with providers of financial products online. **Phishing** is a common Internet scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information. For example, an e-mail may indicate that there is a problem with your bank account and request your social security number or account number. The bank's logo may appear in the e-mail. However, the message is not from the bank; it is from a *phisher* who wants to use the person's information illegally. Do not respond to such an attempt to get personal information. Instead, call your bank directly and ask if there is a problem with your account.

identity theft the use of your personal information by someone else to commit fraud or other crimes

When you use the Internet, your computer is subject to attacks by hackers. *Hackers* try to break into your computer remotely to steal personal information, such as social security numbers. **Identity theft** occurs when someone uses your personal information without permission to commit fraud or other crimes. Those who get your personal information may be able to apply for credit in your name, withdraw money from your accounts, or take possession of other financial assets. You can buy software to help prevent this type of theft. For example, a *firewall* is software or a hardware device that filters information coming in to your computer. You might also choose to store your financial information on a separate storage device, such as a flash drive or CD.

CHECKPOINT

List two ways you can protect your personal financial information.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A professional consultant who provides financial advice for a fee or commission

____ 2. Plans for how you will pay for your personal goals

____ 3. When someone uses your personal information without permission to commit fraud or other crimes

____ 4. A comprehensive plan listing goals along with steps and timelines for reaching them

____ 5. Things you want to achieve in the next two to five years

____ 6. Things you want to achieve in your life

____ 7. A scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information

____ 8. Standards against which progress is measured

____ 9. A visual display of how long it will take to achieve each phase of a plan

a. benchmarks
b. financial goals
c. financial plan
d. financial planner
e. identity theft
f. long-term goals
g. medium-term goals
h. personal goals
i. phishing
j. short-term goals
k. timeline

CHECK YOUR UNDERSTANDING

10. What is the purpose of a financial plan?
11. List the five steps in creating a financial plan.
12. List five types of information or documents that should be gathered as the first step in creating a financial plan.
13. Why are personal goals set before financial goals?
14. How are short-term goals different from long-term goals?
15. What does the term "delayed gratification" mean?
16. How often should you review and update your financial plan?
17. As you review your financial plan, what question should you ask yourself related to your personal net worth statement?
18. Why might you choose a financial planner who does not work on commission rather than one who does?
19. List three sources of good financial advice.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. When preparing a financial plan, is it necessary for you to get advice and help from others, such as a financial planner? Why or why not?
21. Why should you keep good financial records? How can you keep manual records safe? Why is it important to keep them safe?
22. Assess your current financial condition. Do you spend everything you receive? Are there ways you could adjust your spending so you could save more? Are you satisfied with your position as it currently exists?
23. List a personal goal. Then write a short-term financial goal, a medium-term financial goal, and a long-term financial goal based on your personal goal. Why is it important to set each type of goal?
24. Why does your financial plan change over time?
25. Have you ever experienced delayed gratification? Describe the circumstances and explain whether the decision leading to the delayed gratification was a good one. Did it result in reaching your goal? Why or why not?
26. What can you do to protect the security of your computer? How can you protect financial information stored on your computer from unauthorized uses and users?

EXTEND YOUR LEARNING

27. Prepare a list of three personal goals. For each of these goals, write financial goals, stating the costs and methods to be used to pay the costs. These financial goals should be specific, such as working, saving, borrowing, and so forth. Next to each goal, specify benchmarks (steps that allow you to measure your progress) and timelines (specific dates or timeframes for achieving benchmarks). Then prioritize each of your goals, ranking them one to three.
28. Do an Internet search with the keywords *financial planners* or *financial advisers* and prepare a list of people, companies, websites, seminars, and other sources of financial advice. Prioritize the list in terms of where you would seek advice first, second, and so on. Explain your top choice and your bottom choice.
29. Phishers use many sophisticated means to trick their victims into giving out their personal information. Search for articles of recent stories of phishing victims. Select one article and write a summary from the victim's perspective. How was the victim caught off guard? To what lengths did the phisher go to represent an official business or bank? What advice would the victim give to prevent others from falling prey to similar scams?
30. Assume you would like to work as a certified financial planner (CFP) some day. Research the qualifications and skills required. What are the educational requirements? Describe the work environment and characteristics of this occupation. What is the average salary? Compile your research to create a career profile of a certified financial planner.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

MANUFACTURING

Today, consumers need and want many products. Whenever you buy a finished product, somebody worked hard to put it together for you. Workers in production plants assemble both finished products and the pieces that go into them.

Changes in technology have transformed the manufacturing process. Modern systems use robots, computers, motion-control devices, and various sensing technologies. Jobs in manufacturing run from very easy to very complicated. Skilled assemblers put together complex machines by reading detailed schematics.

Careful quality control is essential throughout the process. Today's manufacturing is a "lean" system that uses teams of workers to produce entire products or components. Workers must be able to rotate tasks and look for ways to make a better product in less time. Assemblers are often involved in product development to ensure quality.

Employment Outlook

- Employment statistics are expected to show no or little change.
- Job opportunities are good in high-technology industries.

Job Titles

- Assembler
- Fabricator
- Team assembler
- Structural fabricators

Needed Education/Skills

- GED plus experience and extra training, often on the job
- Manual dexterity; ability to follow detailed instructions

What's it like to work in . . . Manufacturing

Elaine started as an unskilled worker, but through training and experience she has advanced to become a team leader. She arrives for work each morning at 7 a.m. Her team works on an assembly line. Elaine is familiar with all steps in the production process. If another worker is absent, she and/or other team members will fill the gap.

Her day begins as she inspects all the tools and work stations. When the workers on her team arrive, everything will be ready to go. She will assign different tasks to workers so that they can learn all aspects of the job. Elaine makes sure that all quality standards are being met and that substandard units are reworked for later delivery.

Next, Elaine turns her attention to preparing the final report of units produced for the week. She will need this report when attending a meeting later in the week to discuss ways to improve the product.

What About You?

Do you like building things? Would you like to work on an assembly line that puts together high-quality products in an efficient manner? Do you like working on a team to meet output goals? Would you like to be a team leader?

©GeoM, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 4 Assessment

SUMMARY

4-1 Needs are the things required for survival, such as food, clothing, shelter, and medical care. Wants are the things we desire for reasons beyond survival and basic comfort. Limited financial resources limit our ability to satisfy all needs and wants, which are unlimited and growing.

Income is measured using a personal cash flow statement. A personal net worth statement measures wealth or net worth by subtracting liabilities (debts) from assets (items of value that are owned).

Every purchase decision results in a tradeoff between options and an opportunity cost (value of what you give up). The six-step decision-making process will help you compare your options and enable you to make better personal financial choices.

4-2 Budgeting is a critical part of making good financial choices. It allows you to analyze what you are spending and saving and make changes as needed.

Budgeting is a four-step process where you estimate income, plan savings, estimate expenses, and balance the budget.

A variance is the difference between a planned amount and the actual amount of an income or expense item in your budget. Analyzing your variances will help you plan spending and saving better in the future.

Manual and computerized recordkeeping methods will help you stay organized and prepare better financial records.

4-3 Financial planning involves looking at your current financial situation and thinking about your future. It also involves creating a financial plan that contains goals, benchmarks, and timelines.

Five steps in financial planning are gathering information, analyzing information, setting goals, developing a timeline and benchmarks, and implementing and evaluating the plan.

There are many sources of financial advice, including financial planners, financial advisers, and investment advisers. Other sources include financial experts, financial sections of newspapers, magazine articles, seminars and workshops, and financial websites.

It is important to protect your personal information from those who would steal your identity and financial resources. You should work only with financial advisers you know and trust; guard passwords and financial records; be aware of and avoid phishing and similar scams; install a firewall on your computer; and store financial information on separate storage devices.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Complete these problems to build your math skills. You may use spreadsheet software or complete the problems manually.
   a. Michael makes $127 each paycheck and received four paychecks per month. What is his monthly income? His yearly income?
   b. Rachelle makes $96 a week and gets paid 52 weeks a year. What is her yearly income? Her average monthly income?
   c. Maria's budgeted income for July was $539. The actual amount she earned was $522. Compute the variance amount and percent. (Round to the nearest whole percent.) Note if the variance is favorable (F) or unfavorable (U).
   d. Chin's budgeted entertainment expense was $125. The actual amount he spent was $106. Compute the variance amount and percent. (Round to the nearest whole percent.) Note if the variance is favorable (F) or unfavorable (U).

2. **Problem Solving** Assume that you belong to a school club that has ten members and two teacher advisers. The club members and advisers are planning to attend a conference in your state capital. Apply the decision-making process you learned in this chapter to help you decide how your club should travel to the conference. Work with a classmate to complete this activity.
   a. Define the need clearly. Write a statement that says exactly what you need to decide.
   b. List options for meeting the need. What methods of transportation might your club use to reach the state capital? (If you live in the state capital, assume you will need to travel 20 miles to the meeting site.) Do research as needed to find the cost of each option. Remember to consider the distance both to and from the state capital. Record detailed notes to show how the cost for each item was calculated.
   c. Compare the options you have identified. List the advantages, disadvantages, and opportunity costs of each option.
   d. Make a decision based on your research and evaluation of the information you have gathered. Explain why you chose one option over the others.
   e. Describe how you would take action based on your decision if this were a real situation.
3. **Technology** Use a spreadsheet program to create a budget template that could be used for a monthly and yearly budget. Use the categories shown in Figure 4-2.2. You can add any additional categories you believe are needed. Insert formulas for calculating totals.
4. **Economics** Use the Internet to search for information regarding the budget of the United States, prepared by the President. List the major categories of proposed revenues and expenditures. What are some important provisions of the budget? What is the process for getting the federal budget approved?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5. **Research** When looking for a financial planner, it's important that he or she is knowledgeable and trustworthy. Conduct online research to learn what credentials a good financial planner should have. How can you confirm that the financial planner is legitimate? What kind of background information should you know about your planner? Write a one-page report that provides tips on what to do before hiring a financial planner.

6. **Communication** Review the financial plan below, and answer these questions:
   a. Do you think the personal goals are realistic for a student who is currently a sophomore in high school?
   b. Label each personal goal as short-term, medium-term, or long-term.
   c. If this student gets a job, how much will she have to earn in take-home pay in order to meet her financial goals?
   d. How can you add to or refine this plan to make it better?

GLORIA CADIZ
FINANCIAL PLAN
Updated April 1, 20--

Net worth on January 1, 20--: $150

Personal Goals	Financial Goals	Benchmarks	Timeline
1. Get a bachelor's degree in landscape architecture	• Save $2,520 for annual college expenses (books and fees)	• Save $35 per month	72 months (begin saving now and continue through college)
	• Get financial aid to cover college tuition	• Apply for financial aid	January 20-- (next year as junior)
		• Apply for a scholarship	April 20-- (next year)
2. Own a car	• Save $300 for a car down payment	• Save $25 per month	12 months
	• Borrow money from parents	• Get a job so I can repay loan	Get a summer job and a part-time job by January 1, 20--
3. Take a vacation to Hawaii before starting college	• Save $1,500 for vacation	• Save $50 per month	30 months
		• Make reservations early to get the best deal	January, 20-- (in 2 years)
	• Save $300 to buy new clothes for trip	• Save $10 per month	30 months

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Take Action

CREATE A HOUSEHOLD BUDGET

Assume you have graduated from high school and are living on your own. Using Figure 4-2.2 as an example, create a personal budget that will provide for your needs based on the information below. If it is available, use spreadsheet software to create the budget.

a. You work 40 hours per week, 4 weeks per month, and earn $8.00 per hour. Your take-home pay (after taxes and other deductions) is $224 per week. In addition, you earn $60 per month doing odd jobs, such as mowing grass or babysitting for a friend. Enter weekly, monthly, and yearly take-home pay from each source and calculate income totals.

b. Enter an amount you want to save for the month. Use an amount that you think is realistic. You may need to adjust this amount later.

c. List your estimated expenses for one month. Think of all the expenses you would have if you were living on your own. Assume that health insurance premiums are deducted from your paycheck. Also assume that the taxes withheld from your paycheck are all the taxes you have to pay. Thus, you do not need to list these items as expenses. A list of typical expenses for a household budget follows. You may add other items that you think would be realistic and leave out items you don't want.

- rent
- car payment
- telephone
- cell phone
- electricity
- water
- groceries
- clothing and shoes
- Internet access
- gasoline
- lunches at work
- satellite or cable TV
- other entertainment
- car license and repairs
- auto and renter's insurance
- miscellaneous expenses

d. Do research to find typical monthly costs for these items in your area. For example, look at advertisements for apartments in a newspaper to find rent costs. Ask your parents or other adults how much they usually pay for items such as electricity and water. Calculate the total expenses.

e. Calculate the total savings and expenses. Is the budget in balance? If it is not, change the savings or expense amounts (within realistic limits) to make the budget balance. Some ways to balance your budget follow.

- Find an apartment where the utilities are included in the rent.
- Take the bus to work and other places instead of owning a car. You will not have a car payment, gasoline costs, or car insurance costs. Instead, add the cost of bus fares and an occasional taxi fare.
- Have only a cell phone and avoid the cost of a landline phone.
- Consider sharing a two-bedroom apartment with a friend. Your friend would pay half of the rent, electricity, and water expenses.

Save your completed budget in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER

5 The Banking System

©Foto Factory, 2010/Used under license from Shutterstock.com

5-1 Checking Accounts

5-2 Savings Accounts

5-3 Banking Services and Fees

Chapter 5 discusses banking activities for consumers and the banking system of the United States. Many benefits and services for consumers are available from financial institutions. Some accounts have fees or restrictions of which consumers should be aware. Banking in this country is centralized through the Federal Reserve System. In this chapter, you will explore how the banking system works and what it means to you as a consumer. You'll also learn about the rights and responsibilities of account holders.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Games
Chapter 5 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-1 Checking Accounts

GOALS

- Explain the purpose and use of a checking account.
- Prepare checks and deposit slips and maintain a checkbook register.
- Prepare a bank reconciliation and understand account fees and choices.

KEY TERMS

- checking account, p. 149
- check, p. 149
- checkbook register, p. 150
- deposit, p. 150
- withdrawal, p. 151
- postdated check, p. 152
- debit card, p. 153
- endorsement, p. 153
- electronic funds transfer, p. 155
- bank reconciliation, p. 156

What Is the Purpose of a Checking Account?

Commercial banks, savings and loans, savings banks, and credit unions offer various types of accounts to consumers. Collectively, all these financial institutions will be referred to as *banks*. Checking accounts, savings accounts, certificates of deposit (CDs), and money market accounts are popular account choices. In this lesson, we will focus on checking accounts.

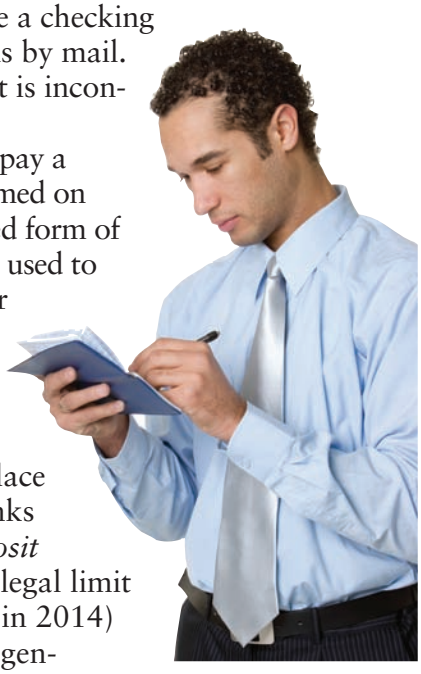
A **checking account** is a demand deposit account on which checks are drawn. It provides a safe place to keep money and allows users easy access to the money in the account. It is a *demand deposit account* because the account holder may withdraw money on demand or write checks on the account at any time. Most people have a checking account for the convenience of paying bills by mail. It is not a safe practice to send cash, and it is inconvenient to buy a money order each time.

checking account a demand deposit in a bank on which checks are drawn

A **check** is a written order to a bank to pay a stated amount to the person or business named on the face of the check. Checks are an accepted form of payment for most bills. Checks may also be used to purchase items in stores. Writing a check for a major purchase is safer than carrying a large amount of cash. A *canceled check* (one that has been processed) also serves as proof of payment for bills or purchases.

check a written order to a bank to pay a stated amount to a person or business

A checking account provides a safe place to keep money. Checking accounts at banks generally are insured by the *Federal Deposit Insurance Corporation (FDIC)* up to the legal limit of $250,000 (to be lowered to $100,000 in 2014) per depositor per bank. The FDIC is an agency of the federal government. By insuring deposits in banks, the FDIC helps to promote public confidence in the U.S. financial system.



Why should you use a checking account rather than cash to pay for purchases and bills?

©Jason Stitt, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Consumers should confirm that a bank's deposits will be insured by the FDIC before opening an account.

OPENING A CHECKING ACCOUNT

To open a checking account, the account holder will need some money (cash or checks). Often, as little as $50 or $100 is needed to open an account. The account holder will be given some checks when the account is opened. These checks will have blank spaces in which to write information about the account. Personalized checks, which have the account holder's name and other data preprinted on them, will be provided a short time later. A checkbook register and a checkbook cover are usually included with the checks. With a typical account, the account holder will be charged a fee for the printing of the personalized checks.

When opening a checking account, the account holder will need to provide personal data. An address, a phone number, and a social security number are usually required. The account holder will also be asked to show a photo ID, such as a driver's license, for identification.

Some banks request that the account holder answer a *security question*, such as "What was your first pet's name?" Others ask for a code word, such as your mother's maiden name. The purpose of a security question or code word is to identify the account holder when he or she calls on the phone or accesses an account online.

The account holder will sign a *signature card* or form. This paperwork provides an official signature that the bank can compare to the signature written on checks. A bank account can be an individual account or a *joint account* that allows two or more persons to write checks on the same account. Each person who is authorized to write checks on the account must have a signature on file with the bank.

KEEPING A CHECKBOOK REGISTER

Keeping accurate records of checking account transactions is very important. Account holders should verify that the amounts deducted from the account and the amounts added to the account are correct. A **checkbook register** is a tool that can be used to track checking account transactions. The register can also provide a record of payments made for bills or purchases.

checkbook register a tool used to track checking account transactions

deposit money added to a checking or savings account

A **deposit** is money added to a checking or savings account. The money can be in the form of currency, checks, or electronic transfers. All deposits, checks, other withdrawals, and fees should be recorded in the checkbook register. The purpose of the transaction can also be recorded. A running balance in the register shows the amount of money in the account. By carefully entering all data related to the account into the register, you can be sure of how much money is in your account at all times. A register can be kept manually or using a computer program such as Excel® or Quicken®. A manual register is shown in Figure 5-1.1.

Always complete the register entry for a check first before writing the check. This process will help ensure that you do not forget to enter the item. Checking the balance in the account before writing a check is a good practice. You want to be sure you have enough money in the account to cover the check.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-1.1 Checkbook Register

CHECK NO. OR TRANSACTION CODE	DATE	DESCRIPTION OF TRANSACTION	PAYMENT/ DEBIT (–)	FEE (–)	✓	DEPOSIT/ CREDIT (+)	BALANCE
							$800 00
581	7/1/--	Food Mart	$ 36 12	.20		$	36 32
		Groceries					763 68
DEP	7/15/--	Deposit Paycheck				220 50	220 50
							984 18
WD	7/16/--	ATM Withdrawal	20 00				20 00
							964 18
582	7/20/--	Bellvue Apts.	600 00	.20			600 20
		Rent					363 98
ON	7/22/--	Metro Gas & Electric	32 50				32 50
		Online Payment					331 48
SC	7/31/--	Monthly Account Fee		5.00			5 00
		July					326 48

In the first column of the register, list the check number or a code to identify the transaction. For example, enter a code such as DEP for deposit, WD for withdrawal, ON for online payment, or SC for service charge. The check number *581* is entered on the first line of the register in Figure 5-1.1.

In the Date column, enter the current date. (The characters "--" are used in Figure 5-1.1 to represent the current year.) In the Description of Transaction column, enter the name of the person or business to whom the check is written. You can also enter the purpose for the check. For example, "Groceries" is entered on line 2 of the register in Figure 5-1.1.

In the Payment/Debit column, enter the amount of the check or other withdrawal. If there is a check fee, enter that amount in the Fee column. In the register in Figure 5-1.1, $0.20 is entered as the check fee. When making a deposit, enter the amount in the Deposit/Credit column. Carry the amount of the payment plus any fee or the deposit to the Balance column. Then subtract the payment or add the deposit amount to find the new balance.

CHECKPOINT

What are the benefits of using checks?

How Do You Write Checks and Make Withdrawals?

An advantage of having a checking account is that the funds are easy to access. When you take money from your account, it is called a **withdrawal**. The account holder can write a check, use a debit card, withdraw cash at an automated teller machine (ATM), or set up a bill to be paid each month automatically. With an *automatic withdrawal*, money is deducted from your account electronically and transferred to another party on a regular basis. For example, insurance premiums could be deducted from your account and transferred to your insurance company. The main

withdrawal taking money from your account

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

advantage of an automatic withdrawal is that by scheduling bill payments, you do not have to remember to write and mail a check each month (but you do have to remember to record it in your checkbook register).

WRITING CHECKS

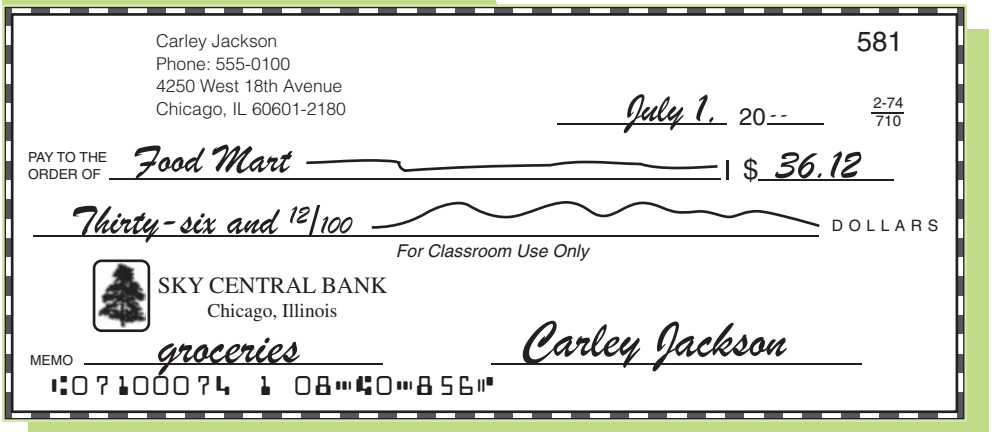
A check is a legal document used to transfer money. When you write a check, you are telling the bank to pay money to the person or company named on the check. As the writer of the check, you are called the *drawer*. The bank from which the funds are drawn is called the *drawee*. The person or company named on the check is called the *payee*. The payee can cash the check or deposit it into a bank account.

Figure 5-1.2 shows an example check. Notice that the account holder's name and address are printed on the check. The check number, 581, appears near the top right of the check. Checks should be written in dark ink, such as blue or black. Write legibly. Fill in the spaces, and do not leave space before or after your writing. Follow these steps as you write checks:

postdated check a check written with a date that will occur in the future

1. *Enter the current date*. Checks should not be postdated. A **postdated check** is a check written with a date that will occur in the future. Banks will not hold postdated checks until the future date; they will process them at once without regard to the date.
2. *Enter the name of the payee on the Pay to the order of line*. Do not leave this line blank. If you do so and lose the check, anyone can cash the check by simply writing the word *Cash* or her or his own name on the blank line.
3. *Enter the amount of the check in numbers after the dollar sign*. Fill the space, separating dollars and cents clearly.
4. *Write the dollar amount in words*. Do not leave extra space anywhere on the line. Draw a line to the end if the space is not filled. Use the word *and* to separate dollars and cents, such as "Fifty-five and 35/100"——Dollars.
5. *Sign your name*. Write your signature in such a way that it matches how you signed it for the signature card at the bank. Do not leave the signature line blank.
6. *Enter a description*. If desired, describe the purpose of the check on the Memo line. For example, write "groceries" as shown in Figure 5-1.2.

Figure 5-1.2 Personal Check



Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

If you make a mistake when writing a check, begin again with a new check. On the check with the error, write VOID in large letters. In the checkbook register, write VOID over the entry in the Description of Transaction column. Draw a line through the check amount and the balance amount. Record the check data again, using the new check number.

©Yuri Arcurs, 2010/Used under license from Shutterstock.com

Why would you use your ATM card to get cash rather than cashing a check?

USING DEBIT CARDS AND ATM CARDS

Your bank may issue you a **debit card**, which can be used to withdraw or deduct money from your checking account. It allows you to withdraw cash at an ATM. It also allows you to make purchases by swiping the card through a point-of-sale (POS) terminal at a store's checkout counter. The effect is the same as writing a check, but the money is electronically removed from your account (debited) and transferred to the business's account. You may also be provided with an *ATM card,* which is similar to a debit card, but its use is limited to withdrawals and deposits made at ATM machines. It cannot be used to make purchases.

debit card a card used to withdraw or deduct money from your checking account

When using an ATM card or debit card with an ATM or POS terminal, the account holder must also enter a personal identification number (PIN) or password. The PIN gives access to the account, so it must be guarded carefully. In some systems, a signature is also required.

Debit cards do not have all the same protections provided with credit cards. Credit cards allow you to reverse or dispute charges. If a debit card is lost or stolen, funds can be removed from your account. Debit cards should not be used for certain types of purchases, such as online purchases where your account information may be unprotected or purchases requiring deposits for which a hold may be placed on your funds.

PROTECTING YOUR ACCOUNT DATA

Check fraud occurs when someone alters a check by changing its amount to obtain more money from another person's account. *Forgery* is the act of signing another person's name on a check. Identity theft occurs when someone uses your personal data without your permission to make purchases, withdraw cash, or borrow money. To help protect yourself from crime, write checks in a proper manner and keep your supply of unused checks in a safe location. When using a debit card or an ATM card, protect your PIN or password and account number. Do not give out your bank account number unless you are sure the person or company receiving it is reputable.

MAKING DEPOSITS

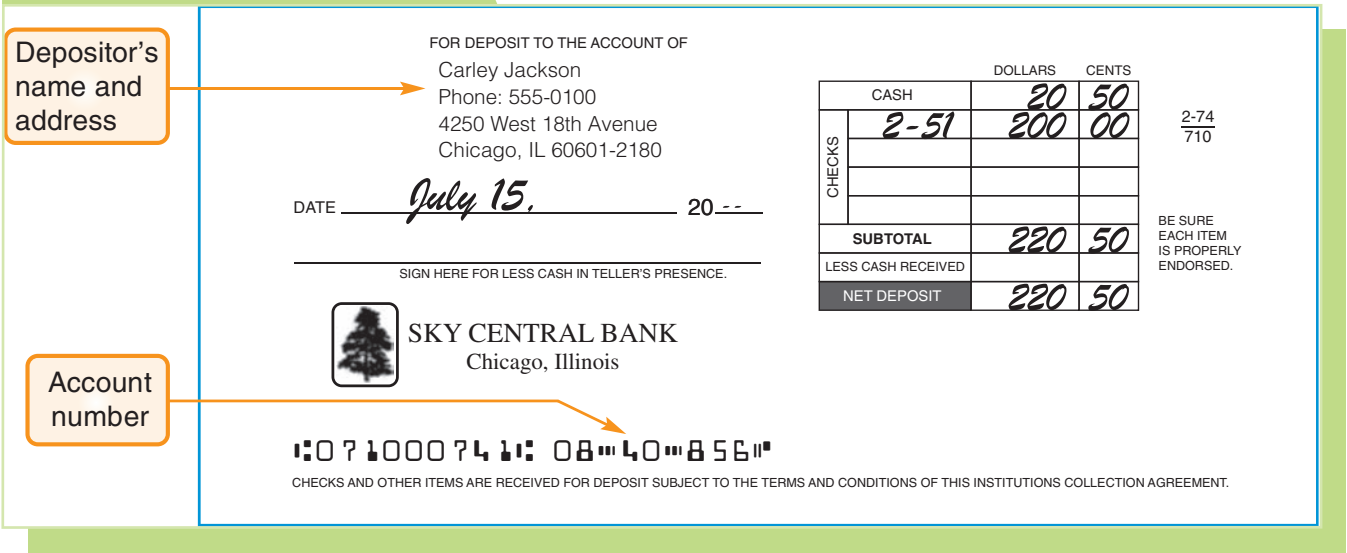
A short time after opening an account, the account holder will usually receive personalized deposit slips, along with checks. Blank deposit slips available at the bank can also be used. Figure 5-1.3 shows a deposit slip for a checking account. Note that the depositor's name and address are printed on the slip. The account number appears at the bottom of the slip.

Checks to be deposited must be properly endorsed. An **endorsement** is a signature, with or without instructions, written on the back of a check. It authorizes the bank to cash or deposit the check. If a check is

endorsement a signature, with or without instructions, written on the back of a check

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-1.3 Deposit Slip



not properly endorsed, it may be returned by the bank to the customer and not deposited. Many checks have an endorsement area printed on the back of the check. If the back of the check is blank, place the check face up, turn the check over while keeping the same edge at the left, and write an endorsement on the left edge of the check.

Some endorsements provide more instructions than others do. Look closely at Figure 5-1.4 as you read about each form of endorsement. With a *blank endorsement*, the signature of the payee is written on the back of the check. The signature must be in ink. This endorsement provides little protection. Anyone who has the check can cash it. This endorsement should be used only when you are at the bank ready to cash or deposit the check.

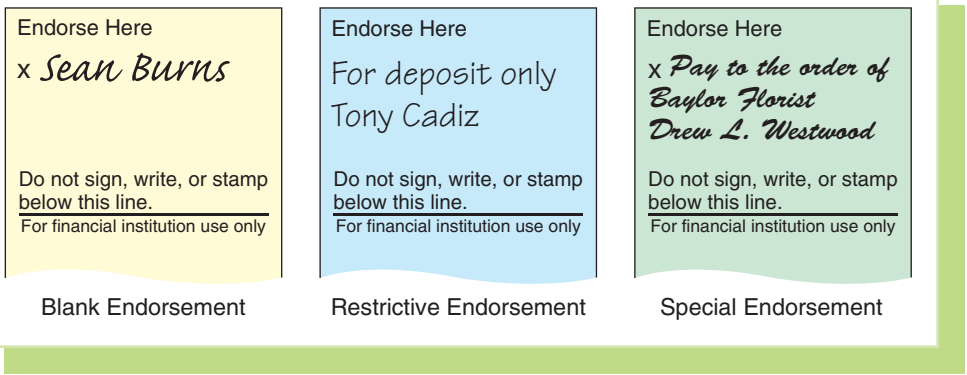
A *restrictive endorsement* restricts or limits the use of a check. For example, *For deposit only* may be written on the check above the signature of the payee. A *special endorsement* transfers the right to cash the check to someone else. The words *Pay to the order of* and the name of the person or company to whom the check is being transferred are written above the signature of the payee. In some instances, a special endorsement is referred to as an *endorsement in full*.

Once the checks are endorsed, you are ready to complete the deposit slip. Follow the steps below to prepare a deposit slip. Refer to Figure 5-1.3 as you read the instructions.

1. Enter the current date on the Date line.
2. Enter the amount of cash (bills and coins) in the Cash section.
3. List checks in the Checks section. For each check, enter the American Banking Association (ABA) number found in the upper-right-hand corner of the check. In Figure 5-1.3, the ABA number for the check to be deposited is "2-51." When a deposit includes more checks than can be listed on the front of the deposit slip, list the other checks on the back of the slip in the spaces provided. Carry the total of those checks to the front of the deposit slip.
4. Enter the total amount of cash and checks in the Subtotal section.
5. Enter the amount of the check(s) you want to receive in cash, if any, in the Less Cash Received section, and sign on the line indicated.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-1.4 Check Endorsements



6. Enter the net deposit amount (subtotal less cash to be received) in the Net Deposit section.
7. Make an entry in your checkbook register to record the deposit.

Deposits can be made in person or at an ATM. If you make a deposit at an ATM, follow the instructions on the screen and get a receipt. Verify that the receipt shows the correct amount of the deposit. It can take a few days for a deposit to be processed, so the account holder may not have access to the money deposited immediately.

Third-Party Checks

A special endorsement creates a *third-party check*, which is a check issued by the check writer (drawer) to the payee, who then endorses and transfers it to a third party. Many banks will not deposit or cash the check from the third party unless he or she has an account with the bank. If the check is bad, the amount of the check will come out of the third party's account. If a bank refuses to cash a third-party check, you may have to use a check-cashing service. A check-cashing business charges a high fee, often a percentage of the check amount.

Direct Deposits

With a *direct deposit*, wages or benefits are automatically deposited into a bank account electronically. An **electronic funds transfer** (EFT) uses a computer-based system to move money from the drawer's account to the payee's account. EFTs are used for automatic withdrawals and deposits. Many people receive social security payments in this manner. Many businesses electronically deposit their employees' net pay. This usually makes it available to employees on the same day it is deposited. The main advantage for account holders is that they have instant access to their money. This method is also safer and more convenient than carrying checks to the bank for deposit.

electronic funds transfer the use of a computer-based system to move money from the drawer's account to the payee's account

CHECKPOINT

Why might it be better to use a restrictive endorsement?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

READING COMPREHENSION

Good reading skills will help you be more productive at school, at work, and in personal activities. Comprehension is the ability to understand what you have read. Reading for comprehension is also called *study reading*. The goal of this type of reading is to learn and to remember what has been read.

To help improve reading comprehension, read slowly and think about what you are reading. Written material is divided into passages. A passage is a group of paragraphs. Paragraphs are used to introduce and explain ideas. Paragraphs often have a common structure. The first sentence of a paragraph is the topic sentence. It tells you what the paragraph is about. The middle sentences explain the topic. The last sentence of a paragraph sums up or draws a conclusion. To improve understanding as you read, think about the purpose of the paragraph and how it relates to the overall topic of the passage.

Many people take notes of major points in each paragraph. Underlining or highlighting can help identify key points when you are reviewing the material. Comprehension can be improved when you read passages more than once. The first time, look for main ideas and points being made. The second time, focus on vocabulary and details.

Try It Out

Find a newspaper or magazine article about the banking industry. Read the article slowly. For each paragraph, jot down the topic (found in the first sentence). Then read the rest of the paragraph and write a brief phrase about it. Then write a sentence describing what you learned from the article.

How Do You Reconcile a Bank Statement?

Once a month, you will receive a statement from the bank. The *bank statement* may be on paper and arrive by mail, or it may be made available to you electronically. The statement will list checks, other withdrawals, and deposits made to the account. It will show the account's beginning balance and ending balance. Any service charges or other fees that have been debited (charged) to the account and any interest earned will also be listed.

When you get a bank statement, you should compare it to your checkbook register. You will adjust the balance shown in the checkbook register to record interest earned or fees charged. You will adjust the balance shown on the bank statement for checks or other withdrawals and deposits that have not yet been processed by the bank. After adjustments are made, the two balances (check register and bank statement) should be the same. This process is called reconciling a bank statement, or **bank reconciliation**. A form may be provided on the back of the bank statement for use in reconciling the account. You can also use programs such as Excel to prepare a reconciliation. A sample bank reconciliation is shown in Figure 5-1.5. Follow these steps in bank reconciliation:

bank reconciliation the process of adjusting the checkbook register and bank statement balances so that they agree

1. Enter the date of the reconciliation and the account number on the reconciliation form.
2. Enter the ending balance date and amount from the bank statement on the reconciliation form. The amount probably will not be the same as the balance shown in your checkbook register.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3. Compare your checkbook register with the bank statement. Verify that the amount of each deposit made is shown correctly on the bank statement. Place a check mark in the check mark (✓) column of the register by each deposit that is shown on the bank statement.
4. On the reconciliation form, list the date and amount of any deposits you made that do not appear on the bank statement. These are called *deposits in transit*. Total the deposit amounts. Add the total deposits in transit to the bank statement balance. Place this amount on the Subtotal line.

Figure 5-1.5 Bank Reconciliation

RECONCILIATION OF BANK STATEMENT

Date August 3, 20--
Account No. 942869

Bank Statement Balance on July 31, 20-- $ 966.68

Add Deposits in Transit and Other Credits

Date	Amount
7/31/20--	220.50

Total Deposits in Transit/Credits 220.50

Subtotal 1,187.18

Deduct Outstanding Checks/Withdrawals

Check No.	Date	Amount
580	7/2/20--	20.00
581	7/29/20--	36.12
ATM	8/1/20--	40.00

Total Outstanding Checks/Withdrawals 96.12

Adjusted Bank Balance $ 1,091.06

Checkbook Register Balance on August 3, 20-- $ 1,096.06

Deduct Bank Charges

Description	Amount
Service charge, monthly fee	5.00

Total Bank Charges 5.00

Subtotal 1,091.06

Add Interest or Other Credits

Description	Amount

Total Credits 0

Adjusted Checkbook Register Balance $ 1,091.06

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5. Compare your checkbook register with the bank statement. Verify that the amount of each check you wrote and each ATM or debit card withdrawal you made is shown correctly on the bank statement. Place a check mark in the check mark (✓) column of the register by each check or other withdrawal that is shown on the bank statement.
6. On the reconciliation form, list the check number or code, date, and amount of any checks and other withdrawals you made that do not appear on the bank statement. Checks written that have not yet been processed by the bank are called *outstanding checks*. Total the outstanding amounts. Subtract the total from the Subtotal calculated in Step 4. The amount left is called the adjusted bank balance.
7. Enter the balance date and amount shown in your checkbook register on the reconciliation form.
8. On the reconciliation form, list any fees or charges shown on the bank statement that are not recorded in the register. Total the amounts. Subtract the total from the checkbook register balance on the form to obtain the Subtotal. Record the fees and charges in your checkbook register and update the balance.
9. On the reconciliation form, list any interest or other credits (additions) shown on the bank statement that do not appear in the register. Total the interest and other credits. Add this total to the amount calculated in Step 8. Record the interest or other credits in the register and update the balance.
10. Compare the adjusted bank balance and the adjusted checkbook register balance. The two amounts should be the same. If they are not, complete the steps again and check your calculations carefully. If the numbers still are not the same, check your calculations in the checkbook register. Also, check for *transposition errors*, which occur when numbers are recorded out of order. For example, you may write a check for $62.26 but record the check as $26.62 in your checkbook register. If you find that any kind of mistake has been made, add or subtract the amount of the mistake to correct the checkbook register balance.
11. In the checkbook register, enter a note in the Description column to indicate that the balance is in agreement with the bank balance on this date; for example, "Register and statement are in balance on August 3, 20--."
12. Store the bank statement and the completed reconciliation form for future reference. Organize the documents by date so you can find a particular statement easily.

TRUNCATED CHECKS

Checks that a bank has processed are called *canceled checks*, or *cleared checks*. In the past, banks returned cleared checks to the account holder. Today, to make processing faster and more efficient, many banks exchange check information electronically by producing a digital image of the check. When a paper check is transformed into a digital image, it is said to be *truncated*. Truncated checks are also known as *substitute checks*. Both sides of the check are scanned to produce the digital image. Truncated checks may be viewed (and a copy printed) by accessing your account online. You may also request that a copy be mailed to you, but

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©AVAVA, 2010/Used under license from Shutterstock.com

Why is it important to be aware of checking account fees and interest earned?

there is often a charge for this service. You must account for all checks, truncated or otherwise, to be sure they have cleared.

OTHER FEES AND INTEREST EARNINGS

Fees and rules for checking accounts vary. Consumers should compare accounts and banks to find the best value for the type of account desired. *Credit unions* are nonprofit financial organizations, and members may be offered free checking accounts with no minimum deposit. Some banks offer free checking accounts to senior citizens and students.

Typical fees include monthly service fees or transaction fees. Monthly service fees range from $5 to $20 a month. Rather than a monthly service fee, some accounts charge a *transaction fee,* such as 20 cents for processing each check you write. Some accounts may allow ten checks at no charge and then have a set charge for each check after that. One-time fees may be charged for making wire transfers, having insufficient funds to cover a check, or allowing your bank balance to fall below the minimum specified for your account. The bank may also charge you for the printing of checks. You will see any bank fees that have been charged on your bank statement. These must be added to your checkbook register.

Some checking accounts do not have monthly service or transaction fees. For example, the monthly service fee may be waived if you keep a minimum required balance in your account. Some checking accounts pay interest on the money you keep in the account. You might choose to have an account that pays a lower interest rate on the deposited amount in order to have no monthly fee. When interest is deposited in your account, it must be entered in your checkbook register and added to your checkbook balance.

CHECKPOINT

What are some of the checking account fees that banks may charge?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The process of adjusting checkbook and bank balances so that they agree

_____ 2. A card used to withdraw or deduct money from your checking account

_____ 3. A tool used to track checking account transactions

_____ 4. A demand deposit account on which checks are drawn

_____ 5. A check wirtten with a date that will occur in the future

_____ 6. Money added to a checking account

_____ 7. A written order to a bank to pay a stated amount to a person

_____ 8. A signature written on the back of a check

_____ 9. The use of a computer-based system to move funds from the drawer's account to the payee's account

a. bank reconciliation
b. check
c. checkbook register
d. checking account
e. debit card
f. deposit
g. electronic funds transfer
h. endorsement
i. postdated check
j. withdrawal

CHECK YOUR UNDERSTANDING

10. What are the purposes of a checking account?
11. What does a bank typically require of a person who wishes to open a checking account?
12. What is the purpose of a signature card?
13. What is the purpose of a checkbook register? What types of data should be in the register?
14. What are the advantages of automatic withdrawal for consumers?
15. What should you do if you make an error while writing a check?
16. What is the difference between a debit card and an ATM card?
17. What is the purpose of a check endorsement? How does a blank endorsement differ from a restrictive endorsement?
18. What is a PIN?
19. What are some advantages of using direct deposit?
20. What is the purpose of completing a bank reconciliation?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. A checking account offers you convenience for bill paying. Many people choose to use cash only. Which viewpoint do you agree with? Why?
22. Some businesses require payment through automatic withdrawals from your checking account. If other payment methods are used, these businesses may charge you more. How do automatic withdrawals benefit businesses?
23. Using debit cards is much more convenient than paying cash or writing a check. Many merchants will no longer accept personal checks because there is so much fraud. What is the downside to using your debit card rather than a credit card or cash?
24. Why do you think someone would use a postdated check? What do you think are the dangers of paying a bill with a postdated check?
25. Many banks will not accept third-party checks unless presented by the account holder in person with a photo ID. If the check is bad, the amount of the check comes out of the account holder's account. Why is this a necessary step by banks?

EXTEND YOUR LEARNING

26. To practice filling out a checkbook register, access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 5. From the data files, open and print the file *CH05 Register*. For each transaction listed below, record the information in the register. Then write the check or complete the deposit slip if one is needed for the transaction. Use the current year for dates. Keep a running balance and double-check your work. The ending balance should be $87.38.
    - Beginning balance $218.33
    - Check No. 401 on April 1 to Westside Services $15.00 for haircut
    - Check No. 402 on April 5 to J. Jill $28.50 for new shirt
    - Cash withdrawal at ATM for $20.00 on April 8
    - Deposit of $25.00 cash on April 10 (gift from uncle)
    - Debit card purchase (DC) of $19.50 on April 11 at Rowe's for food
    - Check No. 403 on April 15 to Bill Baxter $35.00 for loan payment
    - Cash withdrawal at ATM for $20.00 on April 18
    - Debit card purchase of $9.95 on April 25 at Aston Theater for movie
    - Bank service charge on April 28 for $8.00

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-2 Savings Accounts

GOALS

- Discuss the purpose of savings.
- Explain how you can grow your savings with interest.
- List and compare savings options and features.

KEY TERMS

- savings account, p. 162
- principal, p. 163
- simple interest, p. 164
- compound interest, p 164
- annuity, p. 165
- Rule of 72, p. 166
- money market account, p. 167
- certificate of deposit (CD), p. 167
- U.S. savings bond, p. 167
- maturity value, p. 167

What Is the Purpose of Savings?

savings account a demand deposit account designed for the accumulation of money in a safe place for future use

Saving money is important because it means you are providing for future needs and wants. Saving helps you meet your financial goals. A **savings account** is a demand deposit account designed for the accumulation of money in a safe place for future use. The funds are not as easily accessed as with a checking account. The funds, however, are still highly *liquid*, meaning you can generally withdraw your money at any time without penalty. Savings accounts at banks generally are insured by the FDIC up to the legal limit of $250,000 ($100,000 starting in 2014) per depositor per bank.

Savings accounts pay interest at a low rate. However, the rate is usually higher than the rate for a checking account. Some banks allow depositors to link their savings and checking accounts. This allows the transfer of money back and forth (by phone or electronically) at the account holder's convenience.

Having a savings account helps you be prepared for emergencies and other unplanned spending. It gives you flexibility so that you can make better buying decisions. For example, if you have savings, you may be able to buy items at sale prices now rather than later. Buying at sale prices now saves money in the long run. Savings accounts also allow you to accumulate money for large purchases, such as a car or a house. Setting aside money today for use later is a first step in becoming financially secure.

Savings accounts can also be used to hold money temporarily while you are preparing to open an investment account. Money that isn't needed until some time in the future should be invested at a higher rate of return than what savings accounts generally offer.

©Sean Prior, 2010/Used under license from Shutterstock.com

How are savings related to your future?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

THE FDIC

The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the U.S. government. The FDIC protects depositors of insured U.S. banks against the loss of deposits if the bank fails. FDIC insurance is backed by the full faith and credit of the U.S. government. Since the FDIC began operation in 1934, no depositor has ever lost a penny of FDIC-insured deposits.

The FDIC covers all types of deposits, including checking accounts, savings accounts, money market deposit accounts, and certificates of deposit (CDs). The FDIC covers accounts at each insured bank, including principal and any accrued interest through the date of the bank's closing, up to the insurance limit.

The FDIC does not insure:

- money invested in stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities, even if purchased at an insured bank
- valuables stored in the bank's safe deposit boxes
- U.S. treasury bills, bonds, or notes (but these investments are backed by the full faith and credit of the U.S. government)

The standard maximum deposit insurance amount (SMDIA) is $250,000 through December 31, 2013. On January 1, 2014, the SMDIA is scheduled to decrease to $100,000 per depositor per bank for all categories except certain retirement accounts (IRAs), which will remain at $250,000.

The FDIC insures deposits that a person holds in one insured bank separately from deposits the person holds in another separately chartered and insured bank. For example, if a person has an account at Bank A and an account at Bank B, both accounts are insured separately up to the SMDIA. Funds deposited in separate branches of the same insured bank are not separately insured.

Think Critically

1. What is the purpose of FDIC insurance? As a consumer, do you benefit from this insurance?
2. During the Great Depression, many banks failed and people lost their deposits. Do you think such a thing could happen again? Why or why not?

CHECKPOINT

What are the benefits of having a savings account?

How Can You Grow Your Savings?

Growing your savings is an important part of growing your wealth. One way to do this is by earning interest on your savings. When you earn interest, you are actually getting paid to save money!

COMPUTING INTEREST

Money deposited in a savings account will usually earn a set rate of interest. Interest earnings are taxable when they are earned. The sum of money set aside on which interest is paid is called **principal**. Money earned on the principal is called interest. The higher the rate of interest, the more money the account earns.

principal sum of money set aside on which interest is paid

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-2.1 Simple Interest

Interest (I) = Principal (P) × Rate (R) × Time (T)
= $1,000 × 6% Annual Rate × 6 Months
= $1,000 × 0.06 × 6/12
= $30

simple interest interest computed on principal once during a certain time period

When interest is computed on the principal once during a certain time period, this is called **simple interest**. The simple interest method assumes that one interest payment will be made at the end of the period. Interest rates are usually given in yearly rates. However, the interest may be paid after a certain number of months. In this case, the months must be converted into a fraction of a year to compute the interest. The formula for calculating simple interest and a sample problem are shown in Figure 5-2.1.

compound interest interest earned on both principal and previously earned interest

Another way of calculating interest is called **compound interest**, which is interest earned on both principal and previously earned interest. Figure 5-2.2 shows how interest compounds. The principal, $100, was put into savings at an annual rate of 6 percent. The interest was then compounded quarterly (four times per year) for three years. An interest rate of 6 percent per year is 1.5 percent quarterly (0.06 ÷ 4 = 0.015).

THE FUTURE VALUE OF MONEY

The *future value of money* refers to what it will be worth in the future, after interest has compounded. Future value can be compounded based on a single deposit that is left in an account for a long period of time. It can also be based on a series of deposits that are made over time. To compute future value, you can use future value tables, or you can use a financial (business) calculator that has these tables built into its memory.

When computing future value, you will need to know three things: how much money you can set aside; the interest rate it will earn; and how long the money will be set aside. As each of these rises, the amount by which it will grow also rises. For example, $500 will grow faster than $100. An 8 percent rate of return will grow money faster than 6 percent, and so on.

Figure 5-2.2 Compound Interest

Quarterly Compounding
Annual Interest Rate 6%

Year	Beginning Balance	Rate 6%	Quarter				Ending Balance
			1	2	3	4	
1	$100.00	0.015	$1.50	$1.52	$1.55	$1.57	$106.14
2	$106.14	0.015	$1.59	$1.62	$1.64	$1.66	$112.65
3	$112.65	0.015	$1.69	$1.72	$1.74	$1.77	$119.57

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-2.3 Future Value (Compound Sum) of $1

Period	Percent								
	3%	4%	5%	6%	7%	8%	9%	10%	11%
1	1.03000	1.04000	1.05000	1.06000	1.07000	1.08000	1.09000	1.10000	1.11000
2	1.06090	1.08160	1.10250	1.12360	1.14990	1.16640	1.11810	1.21000	1.23210
3	1.09273	1.12486	1.15723	1.19102	1.22504	1.25971	1.29503	1.33100	1.36763
4	1.12551	1.16986	1.21551	1.26248	1.31080	1.36049	1.41158	1.46410	1.51807
5	1.15927	1.21665	1.27628	1.33823	1.40255	1.46933	1.53862	1.61051	1.68506
6	1.19405	1.26532	1.34010	1.41852	1.50073	1.58687	1.66710	1.77156	1.87042
7	1.22987	1.31593	1.40710	1.50363	1.60578	1.71382	1.82804	1.94872	2.07616
8	1.26677	1.36857	1.47746	1.59385	1.71819	1.85093	1.99256	2.14359	2.30454
9	1.30477	1.42331	1.55133	1.68948	1.83846	1.99901	2.17189	2.35795	2.55804
10	1.34392	1.48024	1.62890	1.79085	1.96715	2.15893	2.36736	2.59374	2.83942
11	1.38423	1.53945	1.71034	1.89830	2.10485	2.33164	2.58043	2.85312	3.15176
12	1.42576	1.60103	1.79586	2.01220	2.25219	2.51817	2.81266	3.13843	3.49845
13	1.46853	1.66507	1.88565	2.13203	2.40985	2.71962	3.06581	3.45227	3.88328
14	1.51259	1.73168	1.97993	2.26090	2.57853	2.93719	3.34173	3.79750	4.31044
15	1.55797	1.80094	2.07893	2.39656	2.75903	3.17217	3.64248	4.17725	4.78459
16	1.60471	1.87298	2.18288	2.54035	2.95216	3.42594	3.97031	4.59497	5.31089
17	1.65285	1.94790	2.29202	2.69377	3.15882	3.70002	4.32763	5.05447	5.89509
18	1.70243	2.02582	2.40662	2.54035	3.37993	3.99602	4.71712	5.55992	6.54355
19	1.75351	2.10685	2.52695	3.02560	3.61653	4.31570	5.14166	6.11591	7.26334
20	1.80611	2.19112	2.65330	3.20714	3.86968	4.66096	5.60441	6.72750	8.06231

Saving a Single Sum

Assuming you could set aside $500 and leave it there for ten years at an annual interest rate of 8 percent compounded annually, how much would you have at the end of ten years? To calculate this, you could set up a table, similar to Figure 5-2.2, or you could use the Future Value (FV) of $1 table, as shown in Figure 5-2.3.

Using the table, you would go down the Period column to 10 (ten compounding periods). Then you'd go across to the 8% column. The FV factor from the table is 2.15893. If you multiply $500 times 2.15893, you can determine that the future value will be $1,079.47.

Saving on a Regular Basis

Rather than a lump sum, perhaps you could set aside money regularly. When you set aside a fixed amount on a regular basis over time, it is called an **annuity**. Suppose you could set aside $500 per year for ten years at the rate of 8 percent. Instead of the FV of $1 table, you would now use the Future Value (FV) of an Annuity of $1 table, as shown in Figure 5-2.4 on the next page.

annuity a fixed amount set aside on a regular basis over time

Using the FV of an Annuity of $1 table, go down to period 10 and then across to the 8% column to find an FV factor of 14.48656. Multiply your annual payment of $500 times 14.48656 to determine that you will have $7,243.28 at the end of ten years.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 5-2.4 Future Value of an Annuity of $1

Period	Percent								
	3%	4%	5%	6%	7%	8%	9%	10%	11%
1	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000	1.00000
2	2.03000	2.04000	2.05000	2.06000	2.07000	2.08000	2.09000	2.10000	2.11000
3	3.09090	3.12160	3.15250	3.18360	3.21490	3.24640	3.27810	3.31000	3.34210
4	4.18363	4.24646	4.31013	4.37462	4.43994	4.50611	4.57313	4.64100	4.70973
5	5.30914	5.41632	5.52563	5.63709	5.75074	5.86660	5.98471	6.10510	6.22780
6	6.46841	6.63298	6.80191	6.97532	7.15329	7.33593	7.52334	7.71561	7.91286
7	7.66246	7.89829	8.14201	8.39384	8.65402	8.92280	9.20044	9.48717	9.78327
8	8.89234	9.21427	9.54911	9.89747	10.25980	10.63663	11.02847	11.43589	11.85943
9	10.15911	10.58280	11.02656	11.49132	11.97799	12.48756	13.02104	13.57948	14.16397
10	11.46388	12.00611	12.57789	13.18080	13.81645	14.48656	15.19293	15.93743	16.72201
11	12.80780	13.48635	14.20679	14.97164	15.79360	16.64549	17.56029	18.53117	19.56143
12	14.19203	15.02581	15.91713	16.86994	17.88845	18.97713	20.14072	21.38428	22.71319
13	15.61779	16.62684	17.71298	18.88214	20.14064	21.49530	22.95339	24.52271	26.21164
14	17.08632	18.29191	19.59863	21.10507	22.55049	24.21492	26.01919	27.97498	30.09492
15	18.59891	20.02359	21.57856	23.27597	25.12902	27.15211	29.36092	31.77248	34.40536
16	20.15688	21.82453	23.65749	25.67253	27.88805	30.32428	33.00340	35.94973	39.18995
17	21.76159	23.69751	25.84037	28.21288	30.84022	33.75023	36.97371	40.54470	44.50084
18	23.41444	25.64541	28.13239	30.90565	33.99903	37.45024	41.30134	45.59917	50.39594
19	25.11687	27.67123	30.53900	33.75999	37.37897	41.44626	46.01846	51.15909	56.93949
20	26.87037	29.77808	33.06595	36.78559	40.99549	45.76196	51.16012	57.27500	64.20283

RULE OF 72

Rule of 72 a quick formula for computing how long it will take to double money invested at a given interest rate

A principle called the **Rule of 72** provides a quick formula for computing how long it will take to double money invested at a given interest rate. To apply the Rule of 72, simply divide the annual interest rate into 72. The answer is the number of years it will take at that rate to double the amount invested. For example, if $50 is invested at 6 percent interest, then it will grow to $100 in 12 years (72 ÷ 6 = 12).

CHECKPOINT ▸ ▸ ▸

What three things must you know to compute future value?

What Are Your Savings Options?

When choosing savings options and places to save, consider your financial goals. How much money do you want to save and earn in interest for a particular purpose? How much time do you have in which to save? What interest rate can you earn on your savings? The amount of time

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

you have to save and the interest you can earn determine how much money you need to save each month or year to meet your goals.

When your savings account has reached a "critical mass," it's time to move it to a permanent investment. In other words, as your savings account continues to grow it will pass beyond what you might need for emergencies or planned events. When it does, it's time to set it aside for longer periods of time. All these factors should be considered when choosing a savings option.

METHODS OF SAVING

A savings account is one method for saving your money. Banks offer other savings options that you also should consider.

Money Market Accounts

A savings option offered by some banks is the **money market account**, which pays the market rate of interest on the money deposited. When interest rates are rising, a money market account will often earn more than a savings account or CD. When rates are falling, however, the interest earned may be less than that paid on a CD. A minimum balance, such as $1,000 or $5,000, is often required to open a money market account. The interest rate also may increase as your balance increases. Restrictions may apply to the account. For example, you are usually limited to a certain number of withdrawals each month. If you make more withdrawals than allowed, you will be charged fees.

money market account a type of savings account that earns the market rate of interest on the money deposited

Certificates of Deposit

A **certificate of deposit (CD)** is a time deposit (rather than a demand deposit) that pays a fixed rate of interest for a specified length of time. CDs typically pay higher interest rates than a regular savings account. As a time deposit, the funds must be set aside for a fixed period of time. For example, you may put your money into a six-month CD at a guaranteed rate of 5.25 percent. If you leave your money in the CD for the entire six months, you will earn the full 5.25 percent. If you withdraw part or all of it before the six months, you will be penalized. At some banks, you will lose part of your principal, as well as receive no interest on the money deposited. Because a CD pays a higher interest rate than a savings account, it would be a good savings option if you do not need immediate access to the money.

certificate of deposit (CD) a time deposit that pays a fixed rate of interest for a specified length of time

U.S. Savings Bonds

If you are able to commit your money for a longer period of time, you have other choices. One good long-term choice is a savings bond. A **U.S. savings bond** is a discount bond issued by the federal government that pays a guaranteed minimum rate of interest. *Discount* means you pay less than *face value,* or the amount stated on the face of the bond. For example, you can purchase a $100 (face value) Series EE savings bond for $50. As interest is earned on the bond, it will grow to **maturity value**, which is the bond's future value as stated on its face. In this case, the maturity value is $100.

U.S. savings bonds are considered to be a safe form of saving because they are backed by the U.S. government's full faith and credit.

U.S. savings bond a discount bond issued by the federal government that pays a guaranteed minimum rate of interest

maturity value a bond's future value as stated on its face

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NET Bookmark

Many financial websites include a CD calculator to help you determine how much interest you can earn on a certificate of deposit. By entering principal, time, and interest data into the fields, the calculator will determine the future value for you. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 5. Suppose you deposit $2,000 in a six-month CD with an interest rate of 1.5 percent compounded monthly. What will your ending balance be? Now suppose you deposit the same $2,000 in a two-year CD with an interest rate of 2 percent compounded monthly. What will your ending balance be?

www.cengage.com/school/pfinance/pfl

They pay a guaranteed rate of interest if you keep the bonds until maturity. If you cash the bond before its maturity date, you will forfeit a portion of the interest earned.

Even after a savings bond has matured to its face value, it may continue to earn interest. In general, savings bonds earn interest for different lengths of time. Most types earn interest for up to 30 years. When a bond stops earning interest, it should be cashed in or converted to another type of bond. Interest is not taxable until the bond is cashed. If the bond is used for education expenses (for you or your children), the interest may not be subject to federal taxes.

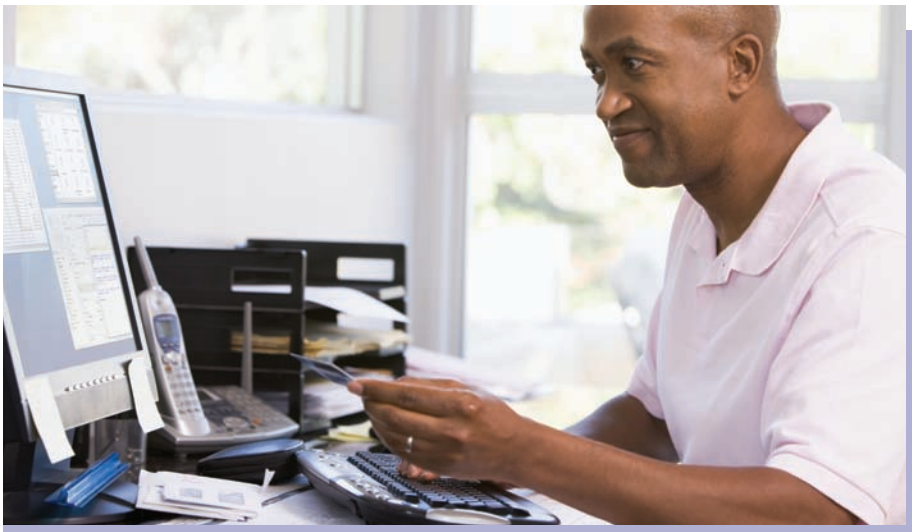
Because it can take several years for a U.S. savings bond to mature, it should be used only as a long-term savings option. U.S. savings bonds can be purchased through banks or at the TreasuryDirect website. You can also see the current rates being paid on bonds at the site.

Individual Retirement Accounts

Saving for retirement is an important goal for many people. One way to save for retirement is by creating an *individual retirement account (IRA)*, also known as an *individual retirement arrangement*. An IRA allows individuals to deposit money into an account during their working years and to delay paying taxes on the money and the interest earned until it is withdrawn during retirement. Because income earned during retirement is often lower than it is during your working years, you likely would be in a lower tax bracket when you withdraw the money, meaning you would pay less tax on it.

IRAs can be set up at a bank or another financial institution. IRAs can also be set up through mutual fund companies, insurance companies, and stockbrokers. Different types of IRAs can be created. The amount of money that can be deposited in the account each year and other rules regarding IRAs are set by the federal government. More information about IRAs can be found in a later chapter and in the Internal Revenue Service's *Publication 590, Individual Retirement Arrangements (IRAs)*, which is available on the IRS website.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



©Monkey Business Images, 2010/Used under license from Shutterstock.com

What should you consider before choosing an online-only bank?

PLACES TO SAVE YOUR MONEY

Banks and credit unions are the most common places where consumers save their money because accounts are FDIC insured. There are other places to save, however, and some of them are also insured.

Online-Only Banks

Online-only banks often pay higher rates of interest than traditional banks. Some online banks also are insured with the FDIC or another insurer. You must have confidence that the online source is reliable. If it also has a traditional brick-and-mortar physical building and presence, an online bank can be just as dependable as traditional banks. You would need to be sure to keep evidence of your account (copies of forms and receipts) as well as check your balances often.

Brokerage Firms

Brokerage or investment firms generally pay higher interest rates on savings accounts. However, they may not be insured by the FDIC or any other insurer. If you have a savings account with a brokerage firm, you usually have the flexibility to move money back and forth between savings and an investment option. Brokerage accounts will be covered more in a later chapter.

International Banks

The Internet opens new possibilities for consumers around the world. As an American citizen, you can hold accounts in other countries. Although you may never visit the bank in person, you will receive your statements and account information online. Your money would be insured through the bank's home country's financial network. In your lifetime, you will see international banking become more commonplace for businesses as well as consumers.

CHECKPOINT

What are some methods for saving money?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. Interest computed on principal once during a certain time period

_____ 2. A bond's future value as stated on its face

_____ 3. A time deposit that pays a fixed rate of interest for a specified length of time

_____ 4. Interest earned on both principal and previously earned interest

_____ 5. A demand deposit account designed for the accumulation of money in a safe place for future use

_____ 6. A discount bond issued by the federal government

_____ 7. A sum of money set aside on which interest is paid

_____ 8. A fixed amount set aside on a regular basis over time

_____ 9. A quick formula for computing how long it will take to double money invested at a given interest rate

a. annuity
b. certificate of deposit (CD)
c. compound interest
d. maturity value
e. money market account
f. principal
g. Rule of 72
h. savings account
i. simple interest
j. U.S. savings bond

CHECK YOUR UNDERSTANDING

10. What is the formula for calculating simple interest?
11. How does compound interest differ from simple interest?
12. What is meant by the future value of money?
13. How is the future value of $1 different from the future value of an annuity of $1?
14. How do a certificate of deposit and a money market account differ from a regular savings account? How are they the same?
15. Why are U.S. savings bonds considered to be a safe form of saving?
16. What is the purpose of an IRA? What types of companies offer IRAs?
17. How do the amount of time you have to save and the interest you can earn relate to achieving financial goals?
18. What is the Rule of 72 that is related to saving?
19. At what point should savings be moved to an investment type of account? Why?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why should you put money into savings, in addition to having a checking account?
21. Why is it important to be able to set aside money for long periods of time? Why should you, as a young person, start saving early?
22. How can compounding interest help you grow your savings?
23. Why would you choose a CD over a money market account?
24. U.S. savings bonds provide a relatively pain-free way to set aside money for the future education needs of you and your children. Why?
25. A regular IRA is tax-deferred. That means you don't pay taxes on the earnings until you begin withdrawing funds during retirement. Why is it advantageous to defer your income taxes?

EXTEND YOUR LEARNING

26. In your local area, there are many banks, credit unions, and other financial institutions that offer savings options such as money market accounts and CDs. With a partner, conduct research using the Internet, using the phone book, visiting the Chamber of Commerce, and using other sources as available to locate the following information:
    a. List all of the banks in your local area. For each one, list the rates on CDs, savings accounts, money market accounts, IRAs, and other types of accounts that may be available.
    b. List all of the credit unions, savings banks, and other financial institutions in your local area. For each one, list the rates on CDs, savings accounts, money market accounts, IRAs, and other types of accounts that may be available.
    c. List all the brokerage firms and other types of businesses that offer savings options in your local area. For each one, list the rates on CDs, savings accounts, money market accounts, IRAs, and other types of accounts that may be available.
    d. List several online-only banks that offer savings options. For each one, list the rates on CDs, savings accounts, money market accounts, IRAs, and other types of accounts that may be available.
    e. Based on the information you have gathered, select the financial institution that best meets your needs in terms of accounts offered. Next to each account, list any costs or disadvantages (such as time requirements or minimum deposit requirements). Also list any restrictions (such as cosigner and minimum activity).
    f. Prepare a report of your findings and your decision. Include with your report any brochures or other information provided by the banks and other financial institutions that you researched. This could include information printed from a bank's website.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-3 Banking Services and Fees

GOALS

- Describe banking services available to consumers at most banks and credit unions.
- Discuss the costs of banking services.
- Explain consumer responsibilities for holders of bank accounts.

KEY TERMS

- safe deposit box, p. 172
- overdraft protection, p. 173
- stop payment, p. 173
- cashier's check, p 173
- money order, p. 173
- Internet banking, p. 174
- smart card, p. 174
- bounced check, p. 175
- inactive account, p. 176
- floating a check, p. 177

What Banking Services Are Available to Consumers?

Financial institutions offer a number of services for consumers. Some of these are included with your checking account. For example, you may be able to have a "free" checking account if you process ten or more debit transactions a month. Other services cost additional money, either on a regular basis, such as monthly or once a year, or as you use them.

SAFE DEPOSIT BOXES

safe deposit box a secure container located in a bank vault

Many banks and credit unions rent out safe deposit boxes as a service to their customers. A **safe deposit box** is a secure container located in the bank vault. You can use it to store important documents, such as deeds and stock certificates, or valuable jewelry, among other things. The safe deposit box protects items from fire or theft. A safe deposit box usually costs from $35 to $100 a year, depending on the size of the box. Many banks require that the fee for the safe deposit box be electronically debited to your account once a year.

©Gemenacom, 2010/Used under license from Shutterstock.com

What is the purpose of a safe deposit box?

To open a safe deposit box, you will need an account at that institution. You will sign a signature card so that the bank can verify who has authority to open the box. You will be given a key for the box, and the bank will also have a key. Both keys must be used to open the box.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

OVERDRAFT PROTECTION

With **overdraft protection**, if you write a check or make a withdrawal from your account and the account does not have enough money to cover the transaction, the bank will cover the shortage. This can be a valuable service to consumers. This service is not automatic; you must sign up for it. Still, it is at the discretion of the bank as to whether or not it will cover an overdraft. If you have a savings account at the same bank where you have a checking account, the bank may allow you to use the savings account for overdraft protection. If you write checks for more money than you have in your checking account, the bank will draw the money from your savings account.

overdraft protection a bank service that covers a shortage in your account

Without overdraft protection, a check would be returned for *nonsufficient funds (NSF)*. In addition to the original amount of the check, you would have to pay fees to your bank and to the person or business to whom you wrote the check. Although banks may charge a fee for overdraft protection, it is usually less than the costs associated with an NSF check.

AUTOMATED TELLER MACHINES (ATMs)

Banks and credit unions also provide ATM machines for their customers. When you use your bank's ATM machine, you are usually not charged a fee for the transaction. Your ATM or debit card allows you 24-hour access to your accounts. You can check balances, withdraw cash, deposit cash and checks, and transfer money between your accounts.

SPECIAL SERVICES

Another service provided by banks is called stop payment. With a **stop payment**, the bank is instructed not to honor a check you issued or lost. The stop-payment order is generally good for six months. After that, the check will no longer be honored because checks over six-months old are not valid for cashing or depositing.

stop payment an instruction to the bank not to honor a check that has been issued or lost

A **cashier's check** is a check issued against bank funds. When you buy a cashier's check, the money comes from your account to pay the bank. The money for the payee of the cashier's check comes from the bank's account. Some people prefer to receive a cashier's check rather than a personal check because a cashier's check is more secure.

cashier's check a check issued against the bank's funds

A *traveler's check* is a special form of check that is used instead of cash or personal checks while traveling. When traveler's checks are purchased, money is taken from your bank account to cover them. With the widespread use of ATM machines and credit cards, the need for traveler's checks has diminished.

Some banks issue money orders. A **money order** is a type of check used to pay bills or make payments for which the money is guaranteed. Those who buy money orders must pay cash for them. The money order is a safe way to send money through the mail. It does not have your bank's account number or other personal information about you that would be found on a check.

money order a type of check used to pay bills or make payments for which the money is guaranteed

Some financial institutions offer *car-buying services*. For a fee of about $500, they will find and buy the new or used car of your choice. This saves you the hassle of negotiating the price for the car. Basically,

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

you are paying the company to negotiate on your behalf. In many cases, the bank or credit union is able to get a better price than you can.

FINANCIAL ADVISING

Some banks offer personal financial advising services. They look at your financial situation and recommend financial products, such as mutual funds, that correspond to your goals and resources. Before investing, check options on your own. Be sure the funds and other financial products you purchase have been in existence for a long time and have performed well over time.

LOANS

Banks use the money you have on deposit, combined with the deposits of other customers, to make loans. Credit unions also offer loans to their members. Because credit unions are nonprofit organizations, members may get lower interest rates on loans. Some examples of the types of loans provided by banks and credit unions are home mortgage loans, car loans, and personal lines of credit.

INTERNET BANKING

Internet banking accessing and managing your account online

Many banks allow their account holders to access and manage their accounts on the Internet. This is known as **Internet banking**. An access code or PIN number along with a user name is needed. Customers can view their accounts at any time on any day. Internet banking typically allows you to do the following:

- check account balances
- check that deposits are posted and checks have cleared
- monitor activity in your account
- view and print statements
- transfer money between accounts, such as from checking to savings
- see interest or fees that have been posted
- pay bills electronically

Internet banking can be as safe as writing paper checks. When deposits and withdrawals are made electronically, nothing can get lost in the mail. Account holders can see exactly how much is in their account at any time.

BANK CARDS

Banks and credit unions issue several types of bank cards. These cards have special features and are electronically coded, allowing you to use them for purchases, cash advances, and deposits. ATM cards and debit cards, discussed earlier in the chapter, are two types of bank cards.

Banks may issue credit cards to their customers who qualify. These cards often have low, fixed interest rates. Because you are a customer, you may be offered a high credit limit.

smart card a card that contains a computer chip that stores electronic money

Similar to debit and ATM cards, banks may issue customers a **smart card**, or *stored value card*, which contains a computer chip that stores electronic money. You deposit money to the smart card electronically when you purchase or renew the card. The card carries an electronic balance. When the money is spent, you can add more money to the card and continue using it. The advantage of a smart card is that it is not linked to your checking account, and if it is lost or stolen, the thief cannot access

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

your bank account. Smart cards often carry the Visa or MasterCard logo, making them acceptable for most kinds of transactions.

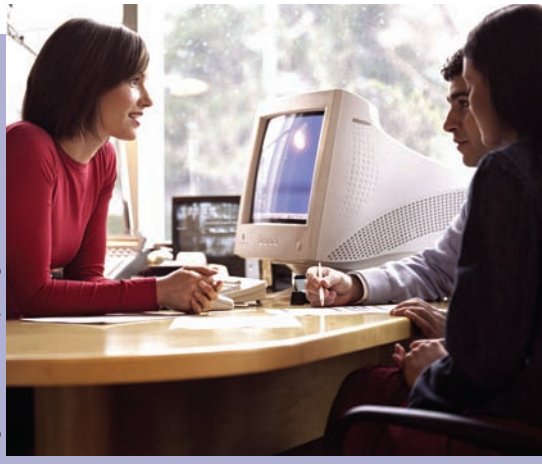
CHECKPOINT

List five banking services available to customers.

What Are the Costs of Banking?

Banks charge their customers fees to help cover their operating costs and to make a profit. Be sure you are aware of what charges can be applied to your account. Fees range from small to large. You can learn about the fees at your financial institution by reading its account brochures. Before you open any account, you should compare services and fees. In many cases, a credit union will offer you the most services for the least cost.

It pays to ask about *relationship banking*, where you work with a bank officer who tries to gain an understanding of your needs and offers services to fulfill those needs. Developing a relationship with your bank allows you to enhance your banking services in a way that could result in lower fees. Your bank may offer suggestions such as carrying higher balances, having multiple accounts, and meeting minimum usage requirements.



Digital Vision/Getty Images

What are the benefits of relationship banking?

MONTHLY ACCOUNT FEES

Many financial institutions charge a monthly service fee for maintaining a checking account. The fee may be $10 or $20 a month or more. Unless you meet a minimum balance requirement, or have a special "free" account, you will be charged this fee. Some savings accounts (usually with small balances) also can be charged monthly account fees. Some banks allow you to link all of your accounts together (such as checking and savings accounts) to meet the minimum balance requirement, allowing you to avoid a service fee.

NONSUFFICIENT FUND (NSF) FEES

One particularly high cost of banking is that of covering a bad check. A check that is not honored by a bank and is returned to the payee's bank because of nonsufficient funds is called a **bounced check**. This means the bank returned the check without paying it. When you write a check but there isn't enough money to cover it, it will "bounce" unless you have overdraft protection. The bank will charge you a fee when this happens—often $30 to $40 per check.

bounced check a check that is not honored by a bank and is returned to the payee's bank due to nonsufficient funds

When a check bounces, the person or business that deposited it will also be charged a fee. You will be expected to cover that fee as well. A bounced check could cost you $80 or more! If you have overdraft protection, NSF checks will be paid rather than bounced. In this case, you would have to pay the amount of the check plus an overdraft fee. However, the fee would be less than the fees associated with a bounced check.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

SPECIAL SERVICE FEES

A bank or credit union typically charges a fee for special services, such as a stop payment. The fee may be $25 or more per check. There also may be a fee for obtaining cashier's checks, traveler's checks, and money orders.

ATM FEES

Many banks will allow you to use their own ATMs free of charge. If you use an ATM from another bank, however, the other bank will charge you a fee of $2 or more. Your own bank may charge an additional fee of $2 or more for processing the transaction with the other bank. If you have a special account or multiple accounts, you can get some or all of these ATM fees waived.

SPECIAL CHARGES

inactive account a checking or savings account that does not meet minimum usage requirements

Banks and credit unions also charge fees for inactive accounts. An **inactive account** is one that does not meet minimum account usage requirements. If your account does not have transactions (such as deposits, debits, checks, or other uses), the financial institution is not making money from those transactions. Thus, they impose fees to cover their costs of maintaining the account. Inactive account fees typically range from $5 to $15 a month. Clearly, if you have an inactive checking or savings account, the balance can be eaten up because of these charges.

CHECKPOINT ▸ ▸ ▸

List five types of bank fees.

What Are Consumer Responsibilities of Banking?

Having a checking and/or savings account is not a right; it is a privilege. Banks, credit unions, and other financial institutions make these accounts available to customers. Using these accounts is a very convenient way to manage money. You have several responsibilities as a consumer.

MAINTAIN YOUR BALANCE

Be certain you have money in your account to cover the checks you write. If you do not monitor your account balance carefully, you might write a bad check by mistake. Knowingly writing a bad check is illegal and unethical. Criminal or civil charges can be brought against a person who writes bad checks. Writing bad checks can also affect your credit rating. You may have trouble borrowing money for large purchases, such as a car, or getting a credit card if you have a poor credit rating.

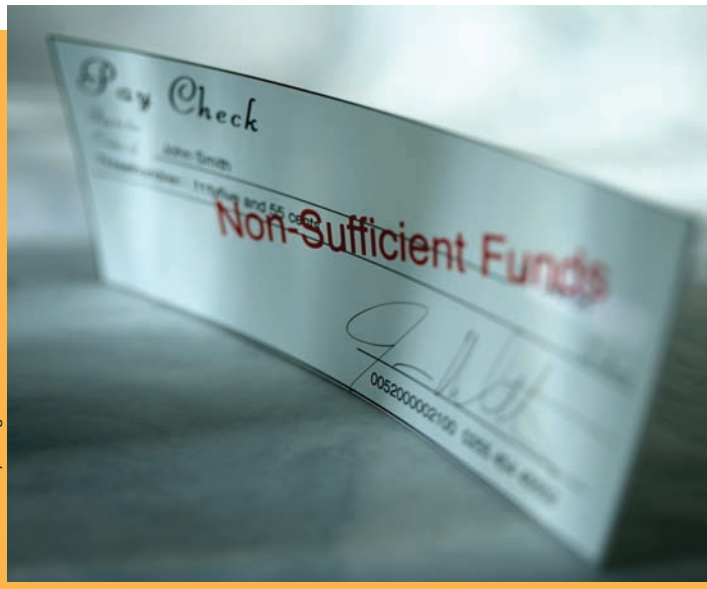
Writing bad checks can be thought of as a form of stealing. Many merchants and individuals who are given bad checks never get the

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

money that is due to them. Merchants pass on some of the cost of bad checks to consumers in the form of higher prices.

Writing a check and planning to deposit money later to cover the check before it is processed is known as **floating a check**. You should write a check only when you have enough money in your account to cover it. In today's electronic age, checks are processed very quickly. You should not expect that you will have time to deposit money before a check clears.

If you allow creditors to make automatic withdrawals from your account, you may want to consider having a separate account for these withdrawals. Each month, before the automatic withdrawal is scheduled, you can transfer money from your main account to the account that will be accessed. This way, others do not have access to your main account where most of your money is kept.



Photodisc/Getty Images

What are the risks of floating a check?

MONITOR YOUR ACCOUNT

Reconciling your bank account is one way to be sure that transactions posted to your account are legitimate. You should also be responsible with your checkbook. Keep your blank checks safe. Be careful to whom you give checks. Once someone has your check, he or she can see your name, address, bank routing number, bank account number, and other information that is printed on the check. Thieves can make and use fake checks based on your account information.

Your bank will not hold you responsible for check fraud. If money is stolen from your account, the bank will reimburse you. However, this raises the costs of banking for everyone, because banks will pass along the cost in the form of higher fees.

floating a check writing a check and planning to make a deposit later to cover it before the check is processed

KNOW YOUR RIGHTS

As a consumer, you have rights with respect to banking. The number of laws to protect consumers in credit and financial transactions has been growing since the 1960s. Congress has assigned the Federal Reserve System (the Fed) with the duty of implementing many of these laws. The laws are intended to ensure that consumers receive complete information and fair treatment by banks, lenders, and other financial institutions. Specific duties carried out by the Fed include educating consumers about consumer protection laws, enforcing consumer protection laws, and managing a consumer complaint program.

Consumer Education

According to the Fed, being a well-educated consumer is the best consumer protection in the market. When you know your rights and responsibilities, you can use information provided to shop and compare banking services. The Fed provides consumer information and free educational materials at its website.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

NEGOTIATING

Negotiation is the process of reaching an agreement that benefits both parties and enables you to get what is important to you. You may have heard the expression, "In life you don't get what you deserve, you get what you negotiate." It's true—people who have good negotiation skills get more of what they want!

The first step in negotiating is to understand your own position. What exactly do you want? In clear, unemotional words, be able to state your wants or needs. Have solid reasons for your choices.

The second step in negotiating is to understand your opponent's position. What exactly does he or she want? What needs and motives does this person have? When you know his or her needs, you can find ways to meet them while meeting yours too.

Third, create a proposed solution. This usually means that you give up something minor to get something that is important to you. It also means the other person will give up something to get what he or she wants.

People with good negotiation skills identify what is important to both sides and what they are willing to give up in order to reach an agreement. Both sides must feel good about what they are getting and what they are giving up.

Try It Out

Meet with your parents. Decide what you would like to change or have them do for you (such as a raise in your allowance). Then decide what you are willing to do (give up) to get that benefit. Consider their point of view—what is important to them. Are you offering them something of value? Negotiate with your parents and come to an agreement. Did you get at least part of what you wanted?

Consumer Protection Laws

The Fed regularly examines financial institutions to ensure compliance with consumer protection laws and regulations. Most banks are evaluated every 48 months, although large banks are examined every 24 months, and poorly rated banks are examined more often.

Consumer Complaint Program

The Fed responds to inquiries and complaints from the public involving consumer protection issues. The Fed maintains information on consumer inquiries and complaints in a database that it regularly reviews to identify trends on which it should investigate further or on which it should educate the public. It aims to uncover unfair or deceptive practices within the banking industry.

It is your responsibility, as a consumer, to file complaints when you believe you have been deceived or defrauded. Only when such violations are reported can appropriate actions be taken to protect you and others from them in the future.

CHECKPOINT ▸ ▸ ▸

What are the three responsibilities of having a bank account?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A type of check used to pay bills or make payments for which the money is guaranteed

____ 2. A checking or savings account that does not meet minimum usage requirements

____ 3. A card that contains a computer chip that stores electronic money

____ 4. A bank service to temporarily cover a shortage in your account

____ 5. Writing a check and planning to make a deposit later to cover it before the check is processed

____ 6. A secure container located in a bank vault

____ 7. Accessing and managing your account online

____ 8. An instruction to the bank to not honor a check

____ 9. A check issued against the bank's funds

a. bounced check
b. cashier's check
c. floating a check
d. inactive account
e. Internet banking
f. money order
g. overdraft protection
h. safe deposit box
i. smart card
j. stop payment

CHECK YOUR UNDERSTANDING

10. How can you obtain a safe deposit box?
11. What is meant by overdraft protection? How can you prevent the need for it?
12. Why would you ask for a stop payment on a check?
13. What is the purpose of a cashier's check?
14. How is a smart card different from a debit card?
15. What is often the requirement to avoid a monthly service fee on your checking account?
16. What is a "bounced" check? How can you avoid issuing a bad check?
17. What are ATM fees? How can you avoid them?
18. What is an inactive account? Why do banks charge customers who have inactive accounts?
19. How does the Federal Reserve System (the Fed) help protect consumers when dealing with banks?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Overdraft protection is a service provided by your bank. Consumers must sign up for the service. Why would you want to have this service? What is the downside?
21. Why would you wish to use a cashier's check? Explain why certain transactions (such as purchasing a used car from a private owner) require the use of a cashier's check.
22. People who do not have checking accounts will often use a money order when they need to send money by mail. This is safer than sending cash. Many businesses will not accept cash in the mail. Why is this the case?
23. A safe deposit box is used to store important documents and other valuable items. What items do you have that you would store in a safe deposit box? What items might your family members want to store in a safe deposit box?
24. Many account holders use the Internet regularly to check their accounts, pay bills, monitor activity, and transfer money between accounts. Why should account holders consider using Internet banking? Is there a downside to this service?
25. What is an advantage of using a smart card rather than a debit or credit card? What is a disadvantage?
26. Fewer and fewer businesses are accepting personal checks as payment for purchases. Discuss possible reasons for this trend. What methods of payment are replacing checks?

EXTEND YOUR LEARNING

27. For a bank, a credit union, and a brokerage or other type of financial institution, compare the banking services that they offer. Work with a partner to answer the following questions:
    a. List the services that are provided with the financial institution's basic checking and savings accounts. List the fees, if any, that are charged for these basic services.
    b. List the fees for any optional services that are provided, such as overdraft protection/NSF checks, stop payments, cashier's checks, traveler's checks, and online banking.
    c. Is there a debit or ATM card available for the account? Are there restrictions for using the ATM or debit card? Are there fees associated with using the cards? If so, explain.
    d. Is there a charge for an inactive account? What are the minimum usage requirements of the account?
    e. Are other special services provided, such as car-buying or financial advising? If so, describe these services and any fees associated with them.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

BANKING

The banking industry has many types of jobs that focus on the primary roles of accepting deposits and lending money. Banks (commercial banks, savings and loans, and credit unions) also offer investment and insurance products. In addition to typical banking services, *global banks* lend internationally and trade foreign currencies. *Regional banks* have many branches and ATM locations throughout a multistate area. *Community banks* are based locally and have fewer locations.

Interest on loans is the main source of income for banks. Loans made to businesses and consumers may include student loans, car loans, mortgages, lines of credit, and credit cards.

Employment Outlook

- Employment is expected to grow at an annual rate of 8 percent through 2018.

Job Titles

- Bank teller
- Loan officer
- Branch manager
- New account clerk
- Customer service representative

Needed Education/Skills

- A high school education is required for entry-level positions. A bachelor's degree is required for management positions.
- Good communication and people skills are a must, as most positions require a great deal of contact with customers.

What's it like to work in . . . Banking

Morgan is a supervisor at a branch office for a regional bank. She knows and understands banking because she started as a bank teller several years ago. Morgan oversees her staff of tellers and loan and account specialists.

Morgan works in her office to review the financial data collected from her branch. She must ensure her branch is meeting company goals and operating smoothly and efficiently. Later in the day, she will meet with customers who wish to discuss financial issues regarding their accounts.

Morgan likes working with people and having a variety of tasks every day. She rises to the challenge of working with customers who are sometimes upset with banking fees and regulations. She considers herself a "personal banker" to those she serves. She wants to be sure her customers are getting the best value for their money.

What About You?

Would you enjoy working with the finances of a bank and its customers? Do you have excellent communication skills? Are you willing to work hard and move up the ranks as your skills improve?

©Leah-Anne Thompson, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 5 Assessment

SUMMARY

5-1 A checking account is a demand deposit that provides a safe place to keep money and allows you easy access to the money. A check is a legal document instructing the bank to pay money to the person or company named on the check.

A checkbook register is a record of checks written, deposits made, other withdrawals made, and other charges made to the checking account.

Writing a check involves six steps: (1) enter the date, (2) enter the name of the payee, (3) enter the amount of the check in numbers, (4) enter the amount of the check in words, (5) sign your name, and (6) enter a description.

Withdrawals from your checking account can be made by writing a check, using a debit card or an ATM card, or setting up automatic withdrawals.

Account holders should reconcile their bank statement by comparing it to their checkbook register.

5-2 A savings account is a demand deposit account designed for the accumulation of money in a safe place for future use.

You can grow your savings by earning interest. Interest is computed using simple and compound interest methods. The future value of money refers to what savings will be worth in the future, after interest has compounded.

Money market accounts and certificates of deposit (CDs) offer higher interest rates than regular savings accounts, but they are also less liquid.

A U.S. savings bond is a good way to save if you can invest the money for a long term. Individual retirement accounts (IRAs) also allow for long-term saving with certain tax benefits.

Places to save money include banks, credit unions, online-only banks, brokerage firms, and international banks.

5-3 Banks may offer services such as safe deposit boxes, overdraft protection, stop payments, cashier's checks, traveler's checks, money orders, financial advising, loans, Internet banking, and bank cards (including credit, ATM, debit, and smart cards).

Banks charge fees for their services, including monthly account fees, NSF fees, stop-payment fees, cashier's and traveler's check fees, money order fees, ATM fees, and inactive account fees.

Consumers are responsible to maintain minimum balances, reconcile and monitor accounts, and know their rights with respect to banking.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** When interest is compounded, interest earned is added to the principal before interest is calculated again. If available, use spreadsheet software to complete these compound interest problems. If not, complete the problems manually or with a calculator. Round answers to the nearest cent.
   a. Gloria has an account that draws interest at the rate of 6 percent per year, compounded monthly at 0.5 percent. The following amounts were deposited in the account in the current year. What is the balance in the account on December 31 of the current year?

      June 1, $50; July 1, $50; August 1, $50; and September 1, $50

   b. Yoshi has an account that draws interest at an annual rate of 5 percent. The interest is compounded quarterly. The following amounts were deposited in the account in the current year. What is the balance in the account on December 31 of the current year (after four quarters)?

      January 1, $450; April 1, $350; July 1, $200; and October 1, $300

2. **Math** Use the tables in Figures 5-2.3 and 5-2.4 to calculate the future value of the amounts below. Round answers to the nearest cent.
   a. Bill deposits $1,000 and leaves it for 8 years in an account paying 6 percent per year. What is the account's value at the end of 8 years?
   b. Andie deposits $700 per year for 8 years in an account paying 7 percent per year. What is her future value (of an annuity)?
3. **Research** Government bonds can be researched and purchased on the TreasuryDirect website (www.treasurydirect.gov). Find information for two types of bonds: I Bonds and EE Bonds. For each type, list the following information:
   - a brief description of the bond
   - the current interest rate paid on the bond
   - the minimum purchase amount
   - the maximum purchase amount per year
   - the redemption process for the bond
4. **Social Studies** Access the Federal Reserve System's website (www.federalreserve.gov) and click on the tab for Consumer Information. Search for an article regarding banks or the banking industry. Write a one-page report on what you learn.
5. **Ethics** Create a pamphlet outlining the rights and responsibilities that banks and bank customers have.
6. **International Studies** Select another country and research its consumer protection laws related to banking. Are there international banks that do business in the United States? If so, what accounts or services are available to American businesses and consumers? How are international banks different from regional or community banks?
7. **Research** Perform research to find a recent news story about the banking industry, rules and regulations in the banking industry, how well banks and other financial institutions are doing in the economy, or some other related topic regarding banks or other financial institutions. Write a one-page report or prepare a PowerPoint presentation describing your findings and explaining what consumers need to know.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8. **History** Today's banking system has a long history. Use the Internet to research the roots of U.S. banking. Create a timeline that shows when the first bank was created and the passage of any laws that helped lay the foundation for today's banks. Provide a brief description of the laws.
9. **Business Law** Many serious crimes involving checks and checking accounts are committed every day, such as writing bad (NSF) checks and committing check forgery. Research the laws in your state related to these crimes. What are the penalties? How can financial institutions and other businesses help prevent these crimes? What can you do to prevent becoming a victim of such crimes?

Take Action

MANAGE A CHECKING ACCOUNT

Point Your Browser

www.cengage.com/school/pfinance/pfl

In this activity, you will update a checkbook register, complete a deposit slip, write checks, and reconcile a bank statement. To practice filling out these forms, access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 5. Use the current year for dates.

a. From the data files, open and print the file *CH05 Forms*. This file contains a deposit form, checks, and a checkbook register.

b. Use the following information to complete the checkbook register and the deposit slip. Show how you would endorse the checks you are depositing using the space provided.

- Date of the deposit: August 30, 20--
- Items to be deposited:

  Checks: 15-456, $108.66
  16-589, $50.00
- Cash received from the deposit: $25.00

c. On August 30, write a check for $15.85 to Quick Pizza for food. Remember to complete the checkbook register before writing the check. Sign your name (first and last) on the check.

d. On August 31, complete the register and write a check for $12.35 to Fresh Cleaners for cleaning services. Sign your name to the check.

e. From the data files, open and print the file *CH05 Statement*. Reconcile the account; the adjusted balances should be $382.29.

After you complete this project, save the forms in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 6

Personal Risk Management

6-1 Risk Assessment and Strategies

6-2 Protecting Income

6-3 Protecting Property

©JHDT Stock Images LLC, 2010/Used under license from Shutterstock.com

In your life, you will face many risks. As you learn about the risks you face, you can decide how serious they are, and then you can decide what to do about them. Buying insurance is one option you can choose to help protect against risk. Avoiding risk, reducing risk, and assuming risk are also options. Income protection is one type of insurance. Health and life insurance are two good ways to protect income. Homeowner's or renter's insurance protects against the loss of your house and personal property. Automobile insurance protects from losses that might occur to you, your car, and others in a car accident. Being aware of and planning for risks is a smart way to help guard your financial security, both now and in the future.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Key Terms Flashcards
Flash Games
Chapter 6 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-1 Risk Assessment and Strategies

GOALS

- Explain the concepts of risk.
- List the three types of risk that consumers face.
- Describe risk assessment and list four risk strategies.

KEY TERMS

- risk, p. 186
- loss, p. 186
- probability, p. 186
- risk assessment, p. 188
- risk reduction, p. 188
- risk avoidance, p. 189
- risk transfer, p. 189
- premium, p. 190
- risk assumption, p. 191
- self-insure, p. 191

What Is Risk?

risk the chance of injury, damage, or economic loss

Risk is the chance of injury, damage, or economic loss. Driving a car and snow skiing are examples of behaviors that involve risk. When you are driving a car, an accident with another car might occur. This accident could cause personal injury and damage to the car. You, your passengers, or passengers in another car might suffer injuries. Or, you might have an accident while snow skiing, such as breaking your leg.

There are many types of risk you will face now and in the future. Some risks are avoidable and have a small chance of occurrence. Other risks are unpredictable and unavoidable. Some risky events may cause serious losses if they happen.

loss a physical injury, damage to property, or disappearance of property

A **loss** refers to some type of physical injury, damage to property, or disappearance of property or other assets. The loss might be personal in nature, such as a broken leg or an illness. The loss could be damage or removal of property. For example, you might lose money and other property as a result of theft.

probability the likelihood of a risk resulting in a loss

Losses could be major and could have a significant effect on your life and future. Losing your job could mean that you cannot make payments on your house or car. Consequently, the lender could seize the property and sell it.

The likelihood of a risk actually resulting in a loss is called **probability**. Just because you take a risk does not mean you will suffer a loss. And just because you avoid a loss once does not mean you will always do so. You must decide whether or not the risk and its possible outcome are serious. If the possible loss is serious, you may be able to take steps to lessen the risk or the resulting loss.

What risks do you take every day? How serious are those risks?

Business owners face additional types of risk. For those who become entrepreneurs, risks and the probability of loss will be measured and provided for differently than for consumers. Risks to business owners include economic conditions, competition, changes in technology, and other forms of systemic risk. *Systemic risk* affects the entire financial market. A business cannot take action to avoid or to lessen the impact of systemic risk. It could include things such as terrorist attacks or a sudden catastrophic event. In addition,

©Ljupco Smokovski, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

businesses face *nonsystemic risk*. These types of risks are nonmarket risks that affect only one company. They can be measured and avoided.

As consumers, we will focus on the three major types of risk that you will face in your lifetime: personal risk, risk of financial loss, and risk of your financial resources.

CHECKPOINT

What is risk as it relates to consumers?

What Are the Types of Consumer Risk?

Risk to consumers comes in several forms. While it is not possible to avoid all risks at all times, it is possible to understand and manage risk. When you understand the risks you are taking, you can take steps to avoid the financial impacts of losses that could occur.

PERSONAL RISK

Taking *personal risk* means you could lose something of personal value to you. For example, you might break your leg and then not be able to participate in an activity you really enjoy. Some personal risks are necessary. If you did not get out of bed in the morning, you could avoid many risks. However, not getting out of bed also means you will accomplish little. If you do not take your umbrella and raincoat when there is a chance of rain, you risk getting wet and cold. This may increase your chances of getting sick. The costs and outcomes of getting sick may not be serious if you are young and likely to recover quickly. For some people who have chronic illnesses, however, this personal risk must be taken seriously because the outcome could be deadly.

RISK OF FINANCIAL LOSS

Some risks will result in financial loss. *Financial loss* refers to a loss in terms of money. The loss can be big or small. Small possible losses should be assessed differently than large possible losses. For example, if you drive without a spare tire, you risk being unable to change a flat tire. Driving without a spare tire could be expensive if you have a flat tire and must pay someone to help you. The money you could lose should be compared to the cost of buying the spare tire.

A large loss might result from driving without car insurance. If you get into an accident, the damage you could cause to another vehicle or property could cost thousands of dollars. You might have to pay this money out of pocket if you have no insurance. In most states, drivers are required to have insurance. If you drive without insurance, you risk being caught and having to pay a fine. Repeated offenses may result in losing your driver's license.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

RISK OF FINANCIAL RESOURCES

Risk of financial resources is a serious kind of risk. It could jeopardize your future. With this type of risk, more than current income is threatened. You may lose your ability to earn in the future or lose assets you will acquire in the future. For example, you might do something that causes an injury to another person. That person might sue you and win a financial *judgment* against you in a court of law. This means that the court orders you to pay the person a certain amount of money. Because of the judgment, you could have your wages garnished (withheld) or your assets taken away. This type of risk has a very grave outcome and should always be taken seriously.

CHECKPOINT

What are three types of consumer risk?

How Can You Manage Risk Using Risk Strategies?

The first step toward managing risk is assessing your risks. Then you must decide on the best strategy for handling the risks you have identified.

RISK ASSESSMENT

risk assessment the process of identifying risks and deciding how serious they are

Risk assessment is the process of identifying your risks and deciding how serious they are. When you understand your risks and what you could lose, you can make better choices. You may be able to take action to protect yourself from the serious outcomes you could face. To assess your risks, you must first understand them. Figure 6-1.1 shows an example of risk assessment. It shows the probability of each risk, and each risk is rated in terms of seriousness. Finally, the chart lists the worst that could happen if each loss occurred.

RISK STRATEGIES

When a risk is serious, you will want to take some type of action to protect yourself. There are a number of ways to do this, such as reducing risk, avoiding risk, transferring risk, and assuming risk.

Reducing Risks

risk reduction finding ways to lower your chance of incurring a loss

The first strategy to consider is how you can lower the risk. **Risk reduction** involves finding ways to lower your chance of incurring a loss. This could be done by changing your actions or other events. For example, when you go snow skiing, you are taking a risk of personal injury. To reduce that risk, you could take skiing lessons and/or choose the least hazardous slopes. You could reduce your risk of financial loss by having health insurance to pay for any injuries you might suffer.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 6-1.1 Risk Assessment

Risk	Probability of Occurrence	Seriousness Rating*	Possible Consequences
Losing my job	Medium	10	• Missed payments • Lower credit rating
Getting in a car accident	Unknown	10	• Personal injury • Lawsuit
Suffering physical injury from snowboarding	Medium	3	• Missed work time • Medical bills
Having bike stolen	Low	2	• New/used bike purchase

*1 is low risk; 5 is medium risk; 10 is high risk

Avoiding Risks

If you decide that you cannot effectively reduce risk and that the potential harm is serious, you might choose to avoid the risk. With **risk avoidance**, you stop the behavior or avoid the situation that leads to the risk. In terms of snow skiing, you would choose not to take part in that activity. This would avoid the risk of injury from a skiing accident.

risk avoidance stopping behavior that leads to a risk

Sometimes, however, avoiding risk means not doing things you really want or need to do. In such cases, you might participate in the risky activities but use other risk strategies that lessen the impact of the possible outcomes.

Transferring Risks

When you face substantial risk that you cannot or do not wish to reduce or avoid, transferring risk is a good option. **Risk transfer**, also called *risk shifting*, occurs when you buy insurance to shift the risk of financial loss to an insurance company. The insurance company pays for the loss caused by damaging events that could occur. If you have health insurance or trip (vacation) insurance, you would have protection from injuries from a skiing accident.

risk transfer buying insurance to shift the risk of financial loss to an insurance company

©Lisa F. Young, 2010/Used under license from Shutterstock.com

How can you transfer the risk of owning and driving your car?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

READING SPEED

Reading speed affects how much material you can read in a certain amount of time. It also can affect how well you remember or comprehend what you read. To be an effective reader, you must read at a pace that allows you to cover material quickly and still comprehend what you are reading. Use these strategies to help you be a more effective reader:

- Select reading material carefully. Choose material that is likely to be of the most value for your reading purpose.
- Preview the material before reading.
- Do not skim or skip passages. Read everything in a passage, chapter, or book.
- Read in the order the information is presented.
- Adjust reading speed to suit the material chosen. Technical material or material with a difficult vocabulary may require slower reading. Summaries, review sections, or passages with easy vocabulary allow faster reading.
- Read groups of words at a time.
- Use a pacer to focus your eyes on the page. A *pacer* is a tool such as a pencil or ruler that you move along under the words being read.
- Read in a quiet place where your concentration will not be interrupted.

Try It Out

Using the Internet, locate an article about risk or risk strategies. Read the article following the steps outlined above. Then answer the following questions:

1. What was the main topic of the entire passage?
2. What two or three new things did you learn?
3. What questions do you have after reading the passage (what additional information would you like to know)?
4. Did you find the passage useful, enlightening, entertaining, or informative? Explain.

As a homeowner, you have many risks. One of them is protecting your household property. You could buy a homeowner's insurance policy that provides coverage against theft. If items are stolen from your home, your insurance would pay you for the value of the items taken.

premium the price you pay for insurance coverage

The price you pay for insurance coverage is called a **premium**. The premium can be paid monthly, quarterly, semiannually, or annually. The premium is based on the possible loss to the insurance company. The more risk the insurer takes, the higher the premium.

Sometimes the cost of the insurance premium is very high, but there are ways to reduce the cost. For example, your homeowner's insurance premiums might be lower if you have a home security alarm system because it will deter burglars and reduce your likelihood of a loss. Your car insurance premium might be lower if you choose to drive a reliable sedan instead of a sports car. Cars are rated according to safety and injury data. If you choose a vehicle that has a higher safety rating, you can save money on premiums. Before you purchase your next car, it would be wise to call your agent and discuss the ratings.

Assuming Risks

When the risk of loss is small or when the cost of transferring the risk is too great in comparison to what you could lose, you might choose

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Ilja Masik 2010/Used under license from Shutterstock.com

Are you assuming risks? If so, what are the risks and can they be avoided or transferred?

to assume the risk yourself. **Risk assumption** is a strategy in which you accept the consequences of risk. It is also known as *risk retention*. Risks that are not avoided or transferred are retained.

risk assumption accepting the consequences of risk

One method of assuming risk is to **self-insure**, which involves setting aside money to be used in the event of injury or loss of assets. You may decide to risk the chance that something will happen and pay for the costs that arise if it does. By setting aside money, you help cushion the financial burden you could incur due to an injury or a loss.

self-insure setting aside money to be used in the event of injury or loss

Many people self-insure as a way to reduce insurance costs. For example, you may choose a health care plan that requires you to pay a higher portion of your medical expenses in exchange for a lower premium. You would pay from your self-insurance fund for doctor visits or other routine care. However, if you have a serious illness that involves high medical expenses, your insurance policy would pay these bills. This allows you to assume the risk for small or routine expenses and have the insurance company assume the risk for large expenses. For many people, this is a better way to manage the risks associated with illness and injury. It saves them money in the form of lower premiums and provides them with an incentive to carefully manage how and when they access medical services and care. Although most people cannot afford to be totally self-insured, it is a good way to assume responsibility for part of the risks faced.

CHECKPOINT

How can you reduce the risk of an automobile accident?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The likelihood of a risk resulting in a loss

_____ 2. Stopping behavior that leads to a risk

_____ 3. Buying insurance to shift risk to the insurance company

_____ 4. The chance of injury, damage, or economic loss

_____ 5. The process of identifying risks and deciding how serious they are

_____ 6. Setting aside money to be used in the event of an injury or a loss

_____ 7. A physical injury, damage to property, or disappearance of property

_____ 8. Finding ways to lower your chance of incurring a loss

_____ 9. The price you pay for insurance coverage

a. loss
b. premium
c. probability
d. risk
e. risk assessment
f. risk assumption
g. risk avoidance
h. risk reduction
i. risk transfer
j. self-insure

CHECK YOUR UNDERSTANDING

10. What kinds of risk do you take each day? What losses would you or your family suffer if one of your risks became a reality?
11. Can you avoid all types of losses? Why or why not?
12. What kinds of risks do businesses face?
13. What is meant by personal risk? Provide an example.
14. What is meant by risk of financial loss? Provide an example.
15. What is meant by risk of financial resources? Provide an example.
16. What is the first step toward managing risks? Why is this step important?
17. What are the four risk strategies?
18. How can you reduce insurance premiums while not increasing your risks to an unacceptable level (such as dropping your insurance policy)?
19. Risks that are not avoided or transferred are retained. What is meant by this statement? Provide an example.
20. What kinds of risks are the best to retain or self-insure?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why is it important to consider the risks you face in life? Everybody faces risk of loss, so why should you be concerned?
22. How are risks of business owners different from risks of consumers? If you decide to open a business, why should you be concerned with those additional risks?
23. Why are risks of financial resources more serious than financial or personal risks? Why is it important to take action to reduce financial resources risks and the loss they could cause?
24. Reducing and avoiding risks usually involve common-sense actions. Give examples of risks you take and what you can do to reduce and avoid those risks. In reducing and avoiding the risks, do you lessen your quality of life? Explain your answer.
25. Why is it essential to transfer (or shift) certain types of risk? In other words, why don't you just reduce, avoid, and assume these kinds of risks? Give two reasons.
26. Self-insuring can reduce the insurance premiums you must pay, but you take on additional risks of loss. It is a situation that creates tradeoffs. In exchange for lower premiums, you will have to pay more out of pocket if a loss occurs. What are the risks versus the benefits of self-insuring?

EXTEND YOUR LEARNING

27. Everyone faces risks—personal risks, financial risks, and resource risks. Assess some of the risks you may face. Follow Figure 6-1.1 as an example as you complete the steps below.
    a. Create a chart with the headings shown below. In the Risk column, list four risks that you face.

Risk	Probability of Occurrence	Seriousness Rating	Possible Consequences	Strategies for Managing the Risk

    b. Estimate the likelihood of those events occurring. Add this information to the chart.
    c. Think about the seriousness of each risk and give it a rating from 1–10, with 10 being the most serious.
    d. List the possible consequences if the risk events should happen.
    e. Consider each possible risk that has a serious consequence. List what you will do to (a) reduce, (b) avoid, (c) transfer, and/or (d) assume the risk.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-2 Protecting Income

GOALS

- Explain the need for health insurance, the types of coverage, and the ways to manage health care and health care spending.
- Explain the need for disability insurance and the types of plans available.
- Explain the need for life insurance and the types of coverage available.

KEY TERMS

- health insurance, p. 194
- fee-for-service plan, p. 194
- preferred provider organization (PPO), p. 194
- health maintenance organization (HMO), p. 195
- stop-loss provision, p. 197
- disability insurance, p. 198
- life insurance, p. 199
- beneficiary, p. 199
- term life insurance, p. 200
- permanent life insurance, p. 200

Why Do You Need Health Insurance?

health insurance a plan for sharing the risk of medical costs from injury or illness

Health insurance is a plan for sharing the risk of medical costs from injury or illness. People need health insurance to help pay high medical expenses. Many people cannot afford to pay medical costs without the help of insurance. Some people have health insurance through a group plan, such as one offered by an employer, while others have individual policies.

TYPES OF PLANS

Three basic types of health insurance plans are available. Health insurance plans have many characteristics in common. The better the coverage, the higher the premiums will be. With group insurance plans, employers often pay for a part of medical insurance premiums. Employees usually pay part as well. Government-sponsored health care plans are also available.

Fee-for-Service Plans

fee-for-service plan a type of health insurance plan that allows the patient to choose medical providers (unmanaged care)

A **fee-for-service plan** allows patients to choose doctors and other providers for medical services. The insurance policy has a *deductible*, which is the amount of money you must pay toward your medical expenses before your insurance company begins to pay. The insured pays expenses equal to the deductible amount. Then the insurance company pays a percent, such as 80 percent, for covered medical services. The insured must pay the remaining amount. For example, if a policy has a $150 deductible, the insured must pay the first $150 of medical expenses. Then the insurance company begins to pay on the amount of costs above the deductible.

A fee-for-service plan is often called *unmanaged care*. This type of coverage is usually more expensive than *managed care* plans such as PPOs and HMOs.

Preferred Provider Organization (PPO) Plans

preferred provider organization (PPO) a network of independent health care providers that work together to provide health care services

A **preferred provider organization (PPO)** is a network of independent health care providers (doctors, hospitals, clinics, and labs) that work together to provide health care services. Patients choose caregivers from approved lists. The caregivers will bill the PPO for services. If you use

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

a doctor or medical facility that is not on the approved list, the plan may pay reduced benefits or no benefits. Thus, you should review the list of approved caregivers and facilities when considering a PPO. The PPO plan usually has a copayment (copay). A *copay* is an amount you must pay each time you use a medical service. Copays are often $15 to $30 per visit. For example, if your doctor charges $60 for an office visit, you would pay the $15 copay at the time of your visit, and the doctor's office would bill the PPO for the $45 balance due.

Health Maintenance Organization (HMO) Plans

A **health maintenance organization (HMO)** is a group plan that provides prepaid medical care for its members. HMOs usually have their own facilities (clinics and hospitals) and offer a full range of services. Patients must choose doctors on the HMO staff, including one doctor to be the primary care physician. To see a specialist, patients must get a referral from the primary care physician. Without a referral, the insurance will not cover the costs. HMOs often do not have deductibles. Patients pay a copay for each visit.

health maintenance organization (HMO) a group plan that provides prepaid medical care for its members

An advantage of HMOs is their emphasis on preventive care. Preventive care includes routine physical exams and wellness programs. The goal is to help keep people healthy and to catch potential health problems before they become serious and costly.

Government-Sponsored Health Care

Medicare is government-sponsored health insurance for people age 65 or older. Medicare is run by the Social Security Administration and funded by employee payroll deductions. Retired people pay a monthly premium for Medicare insurance. *Medicaid* is another form of government-sponsored health insurance for people with low incomes and limited resources. This insurance is designed to help families who live in poverty and are unable to afford private health insurance or medical care.

YOUR ROLE IN HEALTH CARE

You should take an active role in protecting your health. Lifestyle choices include eating healthful foods and reading food labels so that you can avoid additives and preservatives that can harm your body.

In many cases, self-managing through lifestyle changes is better than taking prescription medications that can lead to side effects and lifelong dependency. You might also consider *naturopathic* choices—where you seek natural ways, ingredients, foods, and additives rather than chemically-produced ones.

Many health plans have *call-a-nurse* programs in which a skilled nurse is available by phone to answer health-related questions. Some health plans also have education programs to inform people about ways to stay healthy. You can attend special classes, seminars, and programs (such as for weight loss) or read newsletters.

TYPES OF HEALTH COVERAGE

Several types of health insurance plans are available. Some plans provide coverage for basic health care. Others provide coverage for serious injury or illness. Plans to help pay for dental and vision care expenses are also available.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Basic Health Care

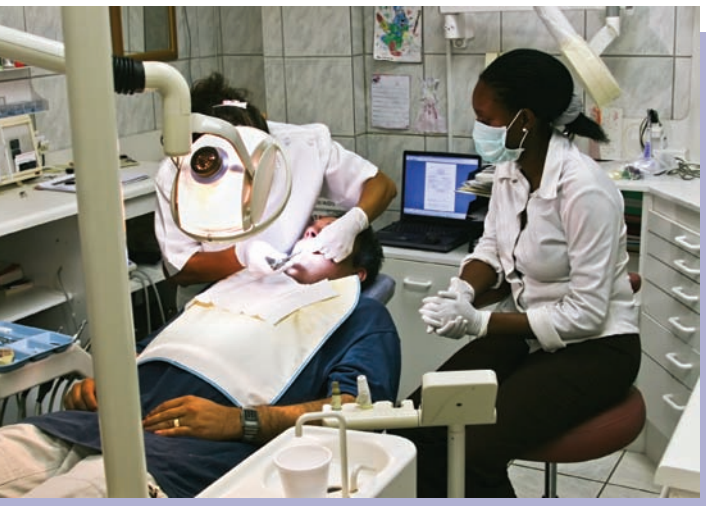
Basic health care coverage includes medical, hospital, and surgery services. It pays for doctor fees, office visits, and lab work. Approved hospital costs and surgeries are also covered. Cosmetic and elective surgeries are usually not covered. *Elective surgery* is surgery you choose to have that is not medically necessary. A facelift to improve appearance and laser eye surgery to improve vision are examples of elective surgery.

Major Medical Costs

Major medical coverage protects against very serious injury or illness. It pays for services beyond basic health care. The coverage often goes to $1 million or more. Examples of procedures covered include bone marrow transplants, organ transplants, other major surgeries, rehabilitation, and extended hospital stays.

Dental and Vision Coverage

Many group plans provide dental coverage. Dental plans often have deductibles and copays. They may have a total yearly benefit, such as $2,000. A typical plan includes services such as exams, X-rays, cleanings, and fillings. Other services, such as crowns, bridges, and braces, often are covered at a lower rate or not at all. Cosmetic dental work, such as teeth whitening, is usually not covered.



©Lucian Coman, 2010/Used under license from Shutterstock.com

Why do dental plans often exclude cosmetic work?

Vision coverage often provides for an eye exam and part or all of the cost of glasses. The insurance pays for lenses and frames and may even allow for prescription sunglasses. Some policies cover the cost of contact lenses, but often on a limited basis.

Catastrophic Illness

Catastrophic illness policies provide protection should you get cancer or some other disease or condition that might cost hundreds of thousands of dollars to treat. If you have a family history of such a disease, you may not be able to get the insurance. You should buy this type of policy (and all policies) only from a well-known, reputable company. These kinds of policies are sometimes sold as scams. When you try to collect, you find that the company will not pay or no longer exists.

Long-Term Care

Long-term care insurance covers the expenses involved in extended care offered in nursing homes, assisted living facilities, or at home by visiting health care professionals. This care generally applies to the elderly, but younger people who suffer debilitating injuries or illnesses may also need this coverage. Although government programs, such as Medicaid, may pay for some long-term care, many people choose to buy long-term care insurance to protect themselves against these costs, which can be extensive and continue to rise.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MANAGING COSTS

The cost of health care is rising rapidly, making it difficult to pay rising premiums. Patients are paying higher copays and deductibles. Types of services provided are often limited. The cost of medicines is also rising. Many people are concerned about finding ways to manage their share of the costs of health care. Whenever possible, patients should make sure medicines and treatments will be covered by their insurance before filling prescriptions. Using generic drugs saves money. However, some alternative or experimental treatments or medicines may not be covered.

Deductibles and Copays

When deductibles and copays are lower, premiums are often higher. Choosing higher deductibles and copays is one way to reduce health insurance premiums. For example, if you raise your deductible from $250 to $500, your premium will be lower. However, you must self-insure, or set money aside, to pay for the higher deductible amount.

Stop-Loss Provisions

A **stop-loss provision** is an insurance policy clause that provides 100 percent coverage of medical expenses after a certain amount of money has been paid by the insured. For example, a policy may have a $5,000 stop-loss provision. This means that when you have paid $5,000 in deductibles plus copays in a year, your covered expenses are then paid at 100 percent. A stop-loss provision is a good feature to have in a health insurance policy.

stop-loss provision a clause that provides 100 percent coverage of medical expenses after a certain amount of money has been paid by the insured

Health Spending Accounts

A health *flexible spending account (FSA)* allows people to set aside money to pay for qualified medical expenses. The money set aside is pretax, meaning no federal income taxes have to be paid on it. The plans are often set up by employer as an employee benefit. Deductions are made from the employee's pay to fund the account. The employer may also contribute. The employee files claims to be paid from the account for qualified medical expenses. Amounts not used by the end of the year are forfeited.

A *health savings account (HSA)* may be set up through an employer or individually. This account often has high deductibles, such as $1,500, on health care plans. The account holder puts money into an account (pretax), which is to be used to pay medical expenses. An HSA is a form of self-insuring with a tax benefit. Unlike the money in an FSA, the money in an HSA that is not used in one year is carried forward to the next year and continues to grow tax-free. The major advantage of this type of plan is that people manage their own health care dollars.

CHECKPOINT

Why do people need health insurance?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...
HEALTH CARE REFORM

In 2010, the United States passed its first comprehensive *health care reform* law. It was passed as a ten-year plan that would occur in phases. By the end of 2020, most Americans will have health insurance coverage. Included are many protections for consumers.

- Thirty-five million uninsured Americans will now be able to buy insurance in pools where they can do comparative shopping.
- The upper limits of health insurance coverage are eliminated. Most policies (individual and group) previously had maximums of $1 million to $2 million.
- Citizens cannot be denied coverage for pre-existing conditions, nor can insurance companies charge higher premiums to people who have pre-existing conditions or who become sick, although older Americans can be charged higher premiums than younger Americans.

In addition, purchasing health insurance becomes mandatory. Low-income Americans will be eligible for subsidies (government grants) if they cannot afford insurance. Employers will be penalized if their provisions for health care are so low that their workers qualify for subsidies.

The cost of health care reform will be supported by increases in taxes in several areas. For example, people with "premium" or high-price health policies will be levied a tax. Additional Medicare taxes will be levied against higher-income individuals and against investment income (rather than just earned income).

Critics point out that a major omission from the reform is a control on costs. Due to rising health care costs, employers and employees will be charged higher premiums. Health care costs have risen much faster than inflation and much faster than increases in most other sectors of the economy. Without controls on costs, affordable health care will continue to be out of reach.

Think Critically

1. Do you agree that health care is a right and not a privilege? Why or why not?
2. How can health care costs be better controlled? What changes would you make to the health care reform package passed into law?

What Is the Purpose of Disability Insurance?

disability insurance insurance that provides income to replace a portion of normal earnings when the insured is unable to work due to nonwork-related injury or illness

Disability insurance provides income to replace a portion of normal earnings when the insured is unable to work due to a nonwork-related injury or illness. (If a person is injured at work or becomes ill because of work conditions, workers' compensation provides coverage.) Recovery from an injury or illness can last weeks, months, or even years. If the disability is temporary, short-term disability insurance provides coverage. When the disability is for a longer period, long-term disability insurance provides coverage.

SHORT-TERM DISABILITY INSURANCE

Short-term disability insurance covers you if you are temporarily unable to work due to an injury or illness. This type of insurance coverage usually begins after a waiting period of 1–14 days. The disabled person receives a portion of regular pay (such as 65 percent) for a short period of time—usually three to six months or up to two years.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Short-term disability insurance is usually offered as part of a group policy that contains health and life insurance. This type of coverage may be provided through an employer-sponsored health plan. It can also be bought as an individual policy. This type of coverage is often overlooked, but it should be considered as an important part of a comprehensive health care package.

LONG-TERM DISABILITY INSURANCE

Long-term disability insurance covers you when you are unable to return to work for a long period of time. It is often used to fill the gap between employment and retirement. Long-term coverage usually begins after short-term disability ends. It continues for approximately two to five years or until retirement. It pays a percentage of regular pay, such as 60 percent. The smaller the payment percentage, the lower the premium will be. Premiums are based on the age of the employee and his or her salary. This insurance may be provided through an employer. Individual policies can also be purchased.

SOCIAL SECURITY DISABILITY

The Social Security Act provides for disability coverage for those who cannot work. To qualify, you must have a permanent (mental and/or physical) disability that prevents you from gainful employment. Disability payments are made to you or on your behalf for living expenses.

CHECKPOINT

Why do working individuals need short-term disability insurance?

Who Needs Life Insurance?

Life insurance pays money to the beneficiary upon the death of the insured person. A **beneficiary** is the person designated to receive the proceeds of the policy. Life insurance protects those you leave behind. For example, it would ensure children have resources to pay for living and education expenses in the absence of an income-earning parent. Some types of life insurance also build cash value, acting as a form of savings plan. Some reasons why people buy life insurance include the following:

life insurance insurance that pays money to the beneficiary upon the death of the insured person

beneficiary the person designated to receive money from a life insurance policy

- To pay off a home mortgage and other debts at the time of death
- To provide money for a spouse and children to maintain their lifestyle
- To pay for education for children
- To make charitable bequests at death
- To accumulate savings
- To pay inheritance and estate taxes
- To provide cash value that can be borrowed later

Two common types of life insurance are temporary and permanent. *Temporary insurance* provides a death benefit only. It does not build cash value. *Permanent insurance* provides a death benefit and builds cash value.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

TEMPORARY INSURANCE

term life insurance temporary insurance that pays only a death benefit and is in effect for a specific period of time

Term life insurance is a policy that provides only a death benefit and is in effect for a specific period of time, such as 20 years. The insured must continue to pay premiums to keep the policy in effect. When the time period is over, the policy is no longer in effect. Term insurance is also called *pure insurance* because it does not build a cash value. If you have a 20-year term policy, you will have life insurance for 20 years. If you die within that period, the policy pays the stated sum, called the face value, to the beneficiary. If you die after the 20-year term, no benefit will be paid. Parents often buy a term policy to cover the financial needs of their children in case the parents should die while the children are still young.

Renewable term insurance gives the insured the right to renew the policy every year or for some other time period. The insured can renew the policy until reaching a certain age, such as 93 or 95 years. The age limit can vary by the company and the type of policy. At each renewal, the premium goes up (because the insured is older and the risk of death increases).

With *decreasing term insurance*, the amount of coverage goes down each year, while the premium remains the same. If the insured dies during the first year of the policy, it pays the full benefit. As each year passes, the death benefit decreases. This type of insurance recognizes that as time goes by, the need for insurance is less. This may be because children are now adults, debts such as a home mortgage are paid down, and there are fewer needs for the life insurance benefit.

With *level term insurance*, the death benefit does not change, but the cost of the premiums can go up each year. This is because the policyholder gets older, and the risk of death is greater.

An advantage of term insurance is that the premium for the policy will be less than for a permanent insurance policy. A disadvantage is that the term policy will not build cash value that can be withdrawn or borrowed against. However, the policyholder could invest the amount saved on premiums. The money invested would likely grow at a faster rate and result in more savings than the cash value of a permanent policy.

PERMANENT INSURANCE

permanent life insurance a policy that provides a death benefit and builds cash value

There are several types of permanent life insurance. **Permanent life insurance** provides a death benefit and builds cash value. When a life insurance policy has a cash value, the insured can borrow against the policy. With some policies, the insured can *cash in* the policy. This means that the policyholder will receive the cash value of the policy, but the insurance benefit will end.

Whole Life

A common type of permanent insurance is called *whole life insurance*. It is also known as *straight life* or *ordinary life* insurance. The insured pays premiums as long as the policy is in effect. There is usually an age limit, such as 93 or 95 years, for how long the policy will remain

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

in effect. The policy pays the face value to the beneficiary at the death of the insured. Life insurance benefits are not taxable to the beneficiary.

The amount of the premium depends on the age of the insured at the time the policy is purchased, as well as the amount of the policy and the desired cash value. As cash value builds, it can be borrowed against by the insured. This type of loan does not have to be repaid. If the insured chooses to not repay the loan, it lowers the death benefit to be paid upon the insured's death. If the borrower pays back the loan, there is no change in death benefit.

©Feng Yu, 2010/Used under license from Shutterstock.com

What is an advantage of permanent life insurance?

Limited-Pay Life

Limited-pay life insurance is a policy on which the insured pays premiums for a limited period of time, such as 20 years. At the end of the period, the policy is paid up. The insured pays no more in premiums, but the life insurance remains in effect until the age limit of the policy. The policy will pay the face value when the insured dies as long as it is in effect. This type of life insurance also builds cash value.

Universal Life

Universal life insurance is a flexible policy that allows the policyholder to change the death benefit and the premiums throughout the life of the policy. The advantage of this type of plan is that it allows the policyholder to adjust the death benefit and premiums to fit changing needs.

Variable Life

Variable life insurance is a form of permanent insurance that provides a death benefit with investment options. The premiums are fixed. The portion of the premium designated to the cash value component is invested in securities (stocks and bonds) chosen by the policyholder. The rate of return is variable according to what the market is doing. The advantage of this type of policy is that the insured can decide how part of the premiums will be invested. The disadvantage is that the death benefit can vary depending on how well the investments do. However, a minimum death benefit is often guaranteed. Also, the insured cannot withdraw the cash value of the policy.

GROUP LIFE INSURANCE

When a life insurance policy is purchased through an employer or an organization, it is called *group life insurance*. Group life insurance insures a large number of people under the terms of a single policy. Group life insurance represents a lower risk to the insurance company because there are more people among which to spread the risk, or the costs. Thus, large groups can usually negotiate better coverage and lower premiums.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

DEALING WITH HEALTH CARE FRAUD

Health care fraud is the false billing for medical services to insurance companies, government, and individuals. Examples of health care fraud include billing for services not performed; falsifying a diagnosis to justify tests, surgeries, and other unneeded medical treatments; misrepresenting procedures to obtain payment; *upcoding*, or billing for a more costly service than the one provided; *unbundling*, or billing for each stage of the procedure as if it were a separate procedure; billing a patient for more than the copay or for services paid by the insurance company; or demanding payment for services which are deemed by the insurance company as excessive charges.

According to Cornell University Law School, ten cents of every health care dollar spent today goes toward paying fraudulent health care claims. The FBI, the U.S. Postal Service, and the Office of the Inspector General are responsible for enforcing and prosecuting health care fraud. Mail fraud involves sending false bills to consumers. The health care provider faces prison, fines, and loss of the right to practice in the medical industry. To help avoid and prevent health care fraud, the consumer has responsibilities, including the following:

- Ask questions about services, such as: Why are they needed? and What do they cost?
- Fill out, sign, and date one claim form at a time.
- Audit bills, verifying that treatments were actually received and questioning any duplications or services not provided.
- Question charges exceeding your copayment amount.
- Report suspected fraud to insurance companies and government agencies.

Think Critically

1. Why is it important for consumers to take an active role in choosing care and comparing prices for health care services?
2. If you suspect that you have been billed for a service you did not receive, or that there is an error in your bill, what should you do?

Group life insurance makes it possible for individuals who would not qualify for an individual policy to have life insurance. Sometimes group life insurance policies are portable. *Portable insurance* can be taken with you when you leave your job. In other words, the group policy becomes an individual policy with the same premiums.

If you are eligible for a group life insurance policy through your employer, it would be worthwhile to learn about it. Find out what the premium would be and compare it to the premium for an individual policy. Ask whether the policy is portable. If the group policy offers lower premiums and portability, you may find it to your advantage to sign up for it.

CHECKPOINT ▸ ▸ ▸

Why is term insurance often better than permanent insurance?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A plan for sharing the risk of medical costs from injury or illness

____ 2. The person designated to receive money from a life insurance policy

____ 3. Insurance that pays money to the beneficiary upon the death of the insured person

____ 4. A type of health insurance plan that allows patients to choose medical providers (also called unmanaged care)

____ 5. A group plan that provides prepaid medical care to its members

____ 6. A policy that provides a death benefit and builds cash value

____ 7. A network of independent health care providers that work together to provide health care services

____ 8. A clause that provides 100 percent coverage of medical expenses after a certain amount has been paid by the insured

____ 9. Insurance that replaces a portion of normal earnings when the insured is unable to work due to nonwork-related injury or illness

a. beneficiary
b. disability insurance
c. fee-for-service plan
d. health insurance
e. health maintenance organization (HMO)
f. life insurance
g. permanent life insurance
h. preferred provider organization (PPO)
i. stop-loss provision
j. term life insurance

CHECK YOUR UNDERSTANDING

10. List the three basic types of health insurance plans that are available.
11. How is a PPO different from an HMO?
12. List the types of coverage available in health insurance plans.
13. How is basic health care different from major medical coverage?
14. What are some things you can do to help manage health care costs?
15. How can a flexible spending account (FSA) or health savings account (HSA) help you save money?
16. What is the purpose of disability insurance? How is short-term disability insurance different from long-term disability insurance?
17. List some reasons why people buy life insurance.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

18. What is the main difference between term and permanent life insurance?
19. What is the face value of a life insurance policy?

THINK CRITICALLY

20. Health insurance protects you in case of injury or illness. Most people are insured through group plans. As a student, you can be covered through age 26 on your parents' policy. Why would you want to buy an individual policy if you are not covered under another plan?
21. Why is it important to find a way to manage the rising costs of health care in this country? (Consider health care spending as a percentage of GDP.)
22. Disability insurance is the most overlooked form of coverage. Why is it important to families?
23. Life insurance protects others (your family). How much life insurance do you need at this point in your life? How might your insurance needs change over time?
24. Why would you choose term insurance, which is temporary, over permanent life insurance? When might you choose permanent insurance instead?

EXTEND YOUR LEARNING

25. You should consider several factors when deciding what type of insurance to buy. Read the following situations, and identify the type of insurance or insurance plan feature you think is right for each one.
    a. You want a health insurance plan that will have low premiums and will allow you to self-insure for routine medical costs. What insurance plan feature should you request?
    b. You want a health insurance plan that sets a limit on the amount of medical expenses you will have to pay out in a given year. What feature should you request?
    c. You want a health insurance plan that will provide coverage should you get cancer or some other disease or condition that might cost hundreds of thousands of dollars to treat. What type of policy should you buy?
    d. You want a life insurance policy on which the premiums will be as low as possible for the next ten years. What type of insurance should you buy?
    e. You want to choose how part of the premiums you pay for life insurance will be invested. What type of policy should you buy? What risk do you face with this type of plan?
    f. You want a life insurance policy that will stay in effect for ten years after you retire. However, you do not want to pay premiums after you retire. What type of policy should you buy?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-3 Protecting Property

GOALS

- Explain the need for and provisions of a homeowner's and a renter's insurance policy.
- Explain the need and types of coverage for automobile insurance.
- Describe ways you can shop for insurance, minimize premiums, and maximize coverage.

KEY TERMS

- homeowner's insurance, p. 205
- liability coverage, p. 206
- home inventory, p. 206
- renter's insurance, p. 207
- automobile insurance, p. 208
- collision coverage, p. 208
- comprehensive coverage, p. 209
- personal injury protection (PIP), p. 209
- uninsured/underinsured motorist coverage, p. 209
- umbrella policy, p. 212

What Is Homeowner's Insurance?

homeowner's insurance a policy that protects against risk of loss to a home and its contents

Regardless of where you live, your property is at risk. *Real property* includes permanent structures, such as buildings. Your home is real property. The contents of your home—such as furniture, appliances, clothing, and home decorations—are called *personal property*. Your home could be destroyed in many ways. Its contents could be lost, damaged, or stolen. **Homeowner's insurance** protects the policyholder from risk of loss to a home and its contents.

TYPES OF COVERAGE

Homeowner's insurance covers three basic types of risk: fire and other hazards, criminal activity, and personal liability. Additional insurance can be purchased to cover severe acts of nature.

Fire and Other Hazards

Fire, water, wind, and smoke can damage a house and its contents. The risk of this type of loss is unpredictable, and the consequences can be very serious. For example, if your house burns to the ground and you have no insurance, you would still be legally bound to make your mortgage payment even though you would have no house to live in. However, most homeowners in such a situation would have difficulty doing so and would likely default on the loan. For that reason, most mortgage lenders require borrowers to carry homeowner's insurance as part of the home loan contract.

Homeowner's insurance protects not only your home but also your garage or shed, trees, plants, shrubs, and fences. Some policies also cover the costs of lodging while your house is being repaired or replaced. Insurance

©magicoven, 2010/Used under license from Shutterstock.com

How can a homeowner protect from losses caused by fire damage?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

policies that provide only fire insurance can be purchased. Although these policies are less expensive, they leave the owner at risk for other types of losses.

Criminal Activity

If your house is broken into, vandalized, or suffers damage as a result of other criminal acts, you are covered. This type of risk is unpredictable, and the consequences can be expensive. After you pay your deductible, you will be reimbursed for the remaining repair expenses and the value of stolen items. Although you may not be able to prevent criminal acts from happening, you can reduce the risk by locking windows and doors. You might also get a security alarm system and put your lights on a timer when you are away from home.

Personal Liability

liability coverage protection against injuries suffered by others on your property or as a result of your actions

If a guest slips and breaks his leg while getting into your hot tub, you are responsible and must accept personal liability. **Liability coverage** provides protection if others are injured while on your property or as a result of your actions. It pays for the medical care and related costs of the injury.

Acts of Nature

Some areas of the country can have hurricanes, floods, volcanoes, or earthquakes. These acts of nature can do a great deal of damage. Coverage for these extreme types of risk is often not included in a regular homeowner's policy. You will have to purchase additional coverage. Sometimes a private insurance company will provide coverage for these risks at high premiums. You may also be able to buy insurance from the federal government to cover these risks. If you live in an area where you could suffer loss from one or more of these types of events, you should consider buying the extra coverage.

HOME INVENTORY

When items are stolen from your home, destroyed, or damaged, you must file a claim with the insurance company in order to be paid for the items. Could you name all the items in your home if it was destroyed by fire? Do you know the value of all the items? Many people would not be able to give an accurate record of home items from memory.

home inventory a list of items of value in your home; used for insurance purposes

To be prepared in case you need to file a claim, you should create a home inventory. The **home inventory** is a list of all the items of value in your home. Ideally, the inventory should include the number of items, when they were purchased, and the original cost. Record as much information as you can. Attach any receipts that you have for expensive items. List serial numbers for items such as appliances and computers. The inventory should include a place to list the replacement cost of the item. That amount can be added just before a claim is filed so the price is current. Figure 6-3.1 shows part of a home inventory. You may want to list items in alphabetical order, by room location, or by type, such as appliances and furniture. You may also want to take pictures of or videotape each room in your home to document the items it contains.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 6-3.1 Home Inventory

	A	B	C	D	E
1	HOME INVENTORY				
2	Updated June 1, 20--				
3					
4	Item	Number	Date	Original	Replacement
5	Description	of Items	Purchased	Cost	Value
6	Air cleaner	2	2/12/2010	$110.78	
7	Ionic Pro Model CA-500B				
8	China place setting including dinner	8	5/25/2006	$414.85	
9	plate, salad plate, cup, saucer,				
10	and bread plate. Pattern: Royal				
11	Albert Old Country Roses				
12	Computer monitor, 17-inch flat panel	1	3/18/2009	$235.25	
13	ViewSonic Model VA7000				
14	Sofa, brown leather, 83 inches long	1	4/5/2010	$2,150.48	
15	Brand: Ethan Allen #28945				
16	Television, plasma, 42" with DVR	1	4/23/2010	$689.56	
17	Sony Model KLV S23A10				
18	Serial # 700 4690				
19					

Once the inventory is complete, store it in a safe place, such as a fireproof box or a safe deposit box. Update the inventory regularly. Keeping the inventory in a spreadsheet or database program makes it easy to update.

Before filing a claim, you should know how you will be paid for damages. This will be explained in your insurance policy. You may be paid for the replacement cost of an item or for the actual cash value of the item. *Replacement cost* is what you would pay today to replace the item, regardless of what the item originally cost. *Actual cash value* is the depreciated remaining value of an item. As an item gets older, such as a television, it often decreases in value. To ensure that you will be able to replace stolen or damaged items at what they would cost today, choose a policy that pays replacement costs.

RENTER'S INSURANCE

The owner of rental property can only insure the building, not its contents. *Tenants* (renters) should purchase **renter's insurance** to protect them against the risk of loss of personal property. Loss could occur from fire, smoke, theft, freezing, water damage, or other hazards. As with a homeowner's policy, you need to know what items and risks are covered and whether the policy pays replacement costs or actual cash value. Purchase a rider if you need coverage for very expensive items, such as jewelry or fine art. A *rider* modifies the coverage of the main policy. Prepare an inventory of items to use if a claim must be filed.

renter's insurance a tenant's policy that protects against the loss of personal property in a rented residence

As a renter, you also have personal liability for what happens inside the residence. If a visitor is injured, renter's insurance will pay the medical and related costs. Renter's insurance also protects your property in your car or at work. Renter's insurance is a low-cost way to protect against personal property loss.

CHECKPOINT

What type of insurance is needed by a homeowner?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Does Insurance Protect Car Owners?

When you drive a car, there are serious risks to people and property. All states have *financial responsibility laws* that require drivers to be prepared to pay for damages caused to others. One way to be prepared is to have automobile insurance. **Automobile insurance** protects a car owner from losses as a result of accidents and other events. The cost of car insurance depends on many things, such as the model and style of car and the age and driving record of the insured.

automobile insurance a policy that protects a car owner from losses as a result of accidents and other events

If your car is stolen or you are in an accident, call the police right away. Get a copy of the police report for use in filing a claim. Call your insurance company to begin the claim process. If your car is damaged but can be driven, you may be required to get estimates for the repair work.

TYPES OF COVERAGE

If you have a car loan, you are required to have full-coverage insurance. *Full coverage* consists of the types of coverage described below.

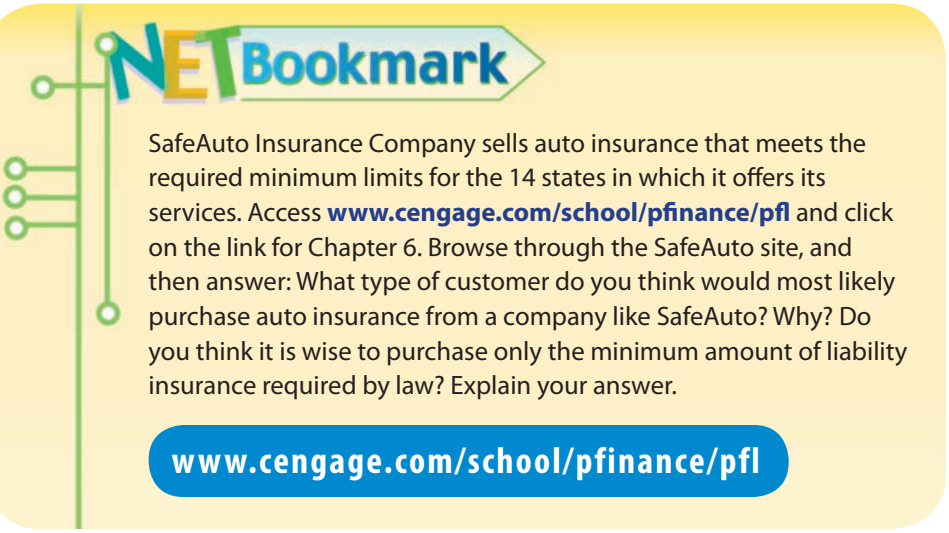
Liability Coverage

Liability coverage protects against loss as a result of injury to another person or damage to that person's property. Liability coverage is required by law in most states. This coverage pays nothing for the insured person's own losses. Liability coverage per accident is usually expressed with three numbers, such as 100/300/50. The 100 stands for how much will be paid for injuries to one person ($100,000). The 300 stands for the total that will be paid for all people in an accident ($300,000). The 50 stands for how much property damage will be paid ($50,000).

Collision Coverage

collision coverage a policy that protects against damage to your own vehicle if you hit another car or lose control and roll over

Collision coverage protects against damage to your own vehicle if you hit another car or lose control and roll over. It pays when you are at fault. If you carry liability insurance only, damage to your car will not be covered. But if an accident is not your fault, the other driver's



Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

insurance will cover the damage. Collision coverage usually has a deductible, which may be from $50 to $1,000. The higher the deductible, the lower your insurance premium will be.

Comprehensive Coverage

Protection against damages to your car from causes other than collision or rolling over is provided by **comprehensive coverage**. Examples of other causes of damage include fire, theft, hail, water, falling objects, and vandalism. This coverage also usually has a deductible.

Personal Injury Protection (PIP)

Personal injury protection (PIP) pays for medical, hospital, and funeral costs of the insured, the insured's family, and other passengers in the insured's car in the event of an accident. Discounts may be available if you have airbags and other safety devices to reduce injuries.

Uninsured/Underinsured Motorist

Uninsured/underinsured motorist coverage provides protection against damages caused by a motorist who is at fault and does not have insurance or the means to pay for your damages. In some cases, the other driver may have insurance but with insufficient coverage to pay for the full extent of your damages. This is known as an *underinsured motorist*. Thus, you should have enough uninsured/underinsured motorist coverage to protect you in case this happens. This insurance also covers you as a pedestrian who is injured by an uninsured motorist.

©Baloncici, 2010/Used under license from Shutterstock.com

What type of coverage pays for damage to your car if a tree limb falls on it?

Towing/Rental Car Coverage

Full coverage often provides for towing charges when your car is not in running order. While your car is being repaired, your insurance may also cover the cost of a rental car. These types of coverage cost extra, but the premiums are fairly low compared to other types of coverage.

comprehensive coverage protection against damages to your car from causes other than collision or rolling over

personal injury protection (PIP) coverage for medical, hospital, and funeral costs of the insured and passengers in the event of an auto accident

uninsured/underinsured motorist coverage protection against damages caused by a motorist with no or insufficient insurance

NO-FAULT INSURANCE

Some states have no-fault insurance laws. Under *no-fault insurance laws*, your auto insurance company will initially pay for your damages (up to your policy limits) regardless of who was at fault for the accident. Your insurance company and the other driver's insurance company will sort out who ultimately pays for the damages later. Even with no-fault insurance laws, the person who causes the accident will be charged with the damages. The basic idea behind no-fault insurance is to avoid the years of legal battling required to determine fault.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

Which type of automobile coverage is required by law in most states?

How Can You Reduce Insurance Costs and Maximize Benefits?

Insurance can be expensive. The costs can be overwhelming if you carry full and maximum coverage for all types of risks to property and income. But there are ways you can reduce costs. This often means raising your overall risk, but in some cases it's necessary so you can manage your budget. You should also carefully review your insurance policy to be sure you are getting the best value for your money.

REDUCING PREMIUM COSTS

To lower the cost of insurance, you should look for ways to reduce your premiums. You can consider any one or a combination of strategies as described below.

Higher Deductibles

Deductibles are present on many types of coverage. When you raise your deductible from, say, $50 to $500, you will lower your premiums. By assuming more risk yourself, you lower the insurance company's risk.

Changing Your Driving Habits

You may be a good driver, but there are still ways you can lower your insurance premium costs.

- Take driver training classes.
- Maintain a good driving record.
- Get good grades in school.
- Choose a car with a high safety rating.
- Install security devices on your car.
- Park your car in a garage or protected area.

You can also do other things to reduce driving risks and to lower your chances of being in an accident, which will help keep your insurance rates low.

- Drive while rested instead of when you are tired.
- Keep your car properly serviced to help prevent breakdowns.
- Avoid heavy traffic situations or driving in bad weather.
- Drive defensively; practice good driving skills; be aware of other drivers.
- Avoid using cell phones, eating, or having other distractions while driving.

Combining or Decreasing Coverage

If you buy more than one insurance policy (for example, homeowner's and car insurance) from the same company, you can get special rates.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

These are called *multiline discounts*. Insurance companies usually provide more than one type of insurance to meet the needs of their customers.

As your car gets older and loses value, you may choose to self-insure and decrease the amount of coverage. By carrying only liability coverage instead of full coverage, you can lower your premiums. However, if your car is destroyed in an accident that is your fault, you would have to pay to replace it.

Comparison Shopping

Insurance premiums are often set based on geography, customer usage rates, company profitability, types of coverage offered, consumer credit ratings, and many other factors. By shopping around and comparing prices, you can save money. You should also be prepared to switch insurance carriers every few years. Otherwise, the premiums can start rising, and you won't be saving money any longer.

You may also be able to save money by purchasing from an insurance agency rather than directly from an insurance company. An *insurance agency* represents several insurance companies and can help you find the best policy to meet your needs, including lower premiums.

How can you reduce your insurance premiums by buying insurance online?

Buying Insurance Online

Consumers can shop online for almost any product or service. Insurance is no exception. When you are looking for property or income protection, the Internet is a good place to begin.

Many insurance companies have websites. Consumers can fill out applications and submit them online. In many cases, rate quotes are received in a few minutes. Consumers can compare prices of policies from different companies. They can buy insurance directly online and be assigned an online agent. Some companies also allow policyholders to file claims using the Internet.

Because consumers do not deal with an agent in person, the cost of these policies may be lower. Before buying insurance online, do research to be sure that the company is reputable and reliable in case you need to file a claim.

Timing of Premiums

If you pay your premiums every six months or yearly, you can usually get lower premiums than if you pay monthly. Some insurance companies will give you lower rates if you set up an *automatic payment* from your checking account.

Piggybacking

Many young drivers get their first insurance as an add-on to their parent's insurance policies. As long as you keep a good driving record, this is most likely your least expensive way to get started. When you go out on your own, you can get a separate policy. Young drivers pay the highest insurance rates because of a higher likelihood of being in an

©East, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

accident. You must build a good driving record to prove you are deserving of lower premiums.

High-Risk Pools

Some states have high-risk insurance pools for drivers with poor driving records. These *high-risk pools* allow those drivers to buy minimum coverage policies (often liability insurance only). Although the premiums are often high, they are typically lower than would be offered by a private insurer. Getting high-risk insurance is a much better option than having no insurance.

Discounts

Many insurance companies give insurance discounts for people with good driving records. They also give discounts when your vehicle has a high safety rating. As you get older, you can also get discounts. For example, achieving age 25 or marriage status is a sign of maturity, which makes you less of a risk and qualifies you for lower premiums. Ask what other discounts are available. Discounts may also be obtained through your credit union, a professional organization, your employer, or some other group.

MAXIMIZING BENEFITS

Because insurance is costly, it is important to know that you are getting a good value. To make sure you are receiving the best coverage for the premiums you are paying, you should review your coverage and consider umbrella insurance.

Review Coverage

Every year or two, you should review your insurance coverage. For example, as your vehicle gets older, your premium should be shrinking. Maybe you should drop certain types of coverage (such as collision) when your car gets older. For your homeowner's insurance, you should be sure that your coverage is increasing as your home's replacement cost is rising. When reviewing coverage, it's also a good time to check prices and comparison shop to be sure your premiums are as low as possible.

Umbrella Insurance

umbrella policy liability coverage above that of your homeowner's and car insurance

An **umbrella policy** is so named because it provides liability coverage above that of your homeowner's and car insurance. It is designed to protect you from extraordinary losses. For example, you may be in an accident in which costs for other persons' injuries exceed $500,000, which is beyond the $300,000 provided by typical liability insurance. Limits for an umbrella policy are often set at $1 million or more. To qualify for umbrella insurance, you must first have liability coverage on your home and car. Then if payment limits are reached on those policies, the umbrella policy takes over.

CHECKPOINT ▸ ▸ ▸

What can you do to lower the costs of your insurance coverage?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

6-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Protection against injuries suffered by others on your property or as a result of your actions

____ 2. A policy that protects a car owner from losses as a result of accidents

____ 3. Coverage for medical, hospital, and funeral costs of the insured and passengers in the event of an accident

____ 4. A policy that protects from risk of loss to a home and its contents

____ 5. Protection against damages to your car from causes other than collision or rolling over

____ 6. A list of items of value in your home used for insurance purposes

____ 7. A policy that protects against damage to your own vehicle if you hit another car or lose control and roll over

____ 8. A tenant's policy that protects against the loss of personal property in a rented residence

____ 9. Protection against damages caused by a motorist with no insurance

a. automobile insurance
b. collision coverage
c. comprehensive coverage
d. home inventory
e. homeowner's insurance
f. liability coverage
g. personal injury protection (PIP)
h. renter's insurance
i. umbrella policy
j. uninsured/underinsured motorist coverage

CHECK YOUR UNDERSTANDING

10. Explain the basic coverage provided by homeowner's insurance.
11. Why do renters need renter's insurance? How is renter's insurance different from homeowner's insurance?
12. Why should renters and homeowners prepare a home inventory? What details should the inventory include?
13. Why do drivers need automobile insurance?
14. What are the basic types of automobile insurance coverage?
15. What is meant by "no-fault" insurance laws?
16. What can you do to reduce risks while driving a car?
17. Why should you review your insurance coverage every few years?
18. What is the purpose of an umbrella policy? Can it be purchased in place of homeowner's and car insurance?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. Why should a homeowner buy homeowner's insurance rather than fire insurance only?
20. Why do most mortgage lenders require borrowers to obtain homeowner's insurance as part of the loan contract?
21. Why do standard homeowner's policies exclude loss from certain acts of nature, such as floods and earthquakes? How can consumers get protection if they live in an area that is subject to these types of risks?
22. When buying insurance, why is it important to know whether the policy pays replacement cost or actual cash value for lost or damaged property?
23. Liability insurance is required in most states. Why is it important for car owners to carry liability insurance? What is the purpose of financial responsibility laws?
24. One person's automobile insurance is $1,200 per year, and another person's is $800. What factors cause the wide variances in insurance premiums?
25. Why are policies purchased from online insurance companies less expensive than policies purchased from an agent you deal with in person? What do you give up in order to get the lower premium cost?

EXTEND YOUR LEARNING

26. Prices for auto insurance vary depending on the company, the age of the driver, the type of vehicle, and other factors. Descriptions of two drivers follow. Work with a partner to get an annual quote for full-coverage auto insurance for each driver. To find quotes, call a local insurance agent. Identify yourself as a student, and ask for a typical price for the driver described. You might also be able to find price quotes at insurance company websites.

    Driver A

    Sheila Roberts is 18 years old. She makes good grades in school and has taken a driver training course. She has had no auto accidents or tickets. The car she will drive is a four-year-old midsize sedan in good working condition. The car is owned by her parents. Sheila wants to be added to her parents' auto policy. She wants two quotes: one for a policy with the lowest deductible and lowest liability coverage available and another for a policy with a higher deductible and higher liability coverage.

    Driver B

    Joe Chung is 19 years old. His college grades are a C average, and he has not taken a driver training course. He has had one traffic ticket for speeding. The car Joe will drive is a two-year-old sports car. He owns the car. Joe wants his own insurance policy (not an add-on to his parents' policy). Because he wants to save money on his premiums, Joe would prefer a higher deductible and the minimum liability coverage.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

INSURANCE

Whenever you buy insurance, the first person you are likely to contact is an insurance agent. Agents are also likely to offer financial planning services, including retirement and estate planning.

Most insurance agents sell a full line of insurance products, including property, life, health, and disability. Many agents also advise people on how to manage risk. For small business owners, insurance agents set up pension plans. Agents prepare reports, maintain records, and seek new clients. When customers experience a loss, agents help them in processing claims.

Insurance agents typically work in small offices, but much of their time may be spent outside of the office meeting with customers.

Employment Outlook

- Employment is expected to grow by 12 percent through 2018.
- The industry is expected to grow as fast as average for all occupations, including those within insurance companies and independent agencies.

Job Titles

- Insurance sales agent
- Financial manager
- Personal financial adviser
- Insurance underwriter
- Claims adjuster
- Insurance investigator

Needed Education/Skills

- A bachelor's degree in business, finance, or economics is preferred.

- Excellent communications and human relations skills are a must.
- A license is required from the state where the insurance is sold.

What's it like to work in . . . Insurance

Juan spends much of his day using the Internet. He is able to stay informed about new insurance products and laws that could affect the insurance industry. He also uses the Internet to stay in contact with his clients and to reach out to new clients. He often provides online price quotations for customers.

As an independent agent, Juan works for commission only—he does not have a monthly salary. Because competition is intense, he is always sensitive to changing client needs.

Juan will be meeting with new clients this morning. He will work with them to determine the kinds of risk they face now and in the future, including personal, property, and liability risks. Based on the information he gathers, he will put together an insurance policy that meets their needs.

What About You?

Would a job in sales appeal to you? Are you interested in helping people assess their risks and develop strategies to insure against those risks?

©R. Gino Santa Maria, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 6 Assessment

SUMMARY

6-1 Risk is the chance of injury, damage, or economic loss. Everyone takes risks that have potential consequences that may be serious.

There are three types of consumer risk: personal risk, risk of financial loss, and risk of financial resources.

Risk can be managed by conducting a risk assessment, which is the process of identifying risks, their probability, their seriousness, and ways to handle them.

Risk strategies include reducing risk, avoiding risk, transferring risk, and assuming risk.

6-2 Health insurance is needed to help pay for high medical expenses. Health insurance plans include fee-for-service, PPOs, and HMOs.

Types of health coverage include basic health care, major medical, dental and vision, and catastrophic illness.

There are many ways to manage health care costs, including use of deductibles, copays, and health spending accounts.

Disability insurance provides income when the insured is unable to work due to nonwork-related injury or illness.

Life insurance can help people protect the ones they leave behind as well as provide a form of savings.

Term life insurance (temporary life insurance) provides a benefit at the death of the insured. Permanent life insurance provides a benefit at the death of the insured and also builds cash value.

6-3 Homeowner's insurance covers fire and other hazards, criminal activity, and personal liability. Renter's insurance provides similar coverage on the contents of a residence but not on the structure. It also includes liability protection.

A home inventory provides records of property and its value.

Automobile insurance provides liability, collision, comprehensive, personal injury, and uninsured/underinsured motorist coverage.

You can lower premiums by increasing deductibles, changing driving habits, combining coverage, comparison shopping, buying online, adjusting timing of premiums, piggybacking, and taking discounts.

An umbrella policy provides liability coverage above and beyond the coverage offered by your homeowner's or car insurance.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Compute the following insurance costs:
   a. Takashi Caldwell has health insurance that pays 80 percent of covered charges after a $150 deductible. She received a statement for $350 of covered charges. How much will Takashi have to pay?
   b. Ryan Maderas has health insurance that pays 80 percent of covered charges after a $500 deductible. There is a stop-loss provision of $5,000. The insurance company has paid $16,000 (which is 80 percent of the medical expenses after the deductible). Assuming all charges were covered, how much has Ryan paid for medical costs?
   c. Mel Adams has homeowner's insurance that pays 90 percent of the replacement cost of items damaged in a fire. He had a fire in his kitchen, and the electric stove was damaged beyond repair. Mel paid $350 for the stove five years ago. The cash value of the stove before the fire was $100. A new stove with the same features will cost $400. How much will his insurance company pay?

2. **Research** Financial responsibility laws vary by state. Work with a classmate to learn what the financial responsibility laws of your state require. Using an Internet search engine, enter your state's name and the term *financial responsibility laws*. Read the information you find about the laws for your state. Record the following information:
   - The name and address of the website(s) where you found the information
   - People to whom the financial responsibility laws apply
   - Methods that can be used to meet the requirements of the laws
   - Situations in which individuals may be required to offer proof that they are complying with the laws
   - The minimum amount of each type of insurance that must be carried to satisfy the laws
   - Penalties for breaking the laws
3. **History** Throughout history, natural disasters have created serious economic problems, from repairs and rebuilding to disease and unemployment. Write a two-page report about a natural disaster and its impact on the economy of the area where the event occurred. Examples: the San Francisco Earthquake of 1906; the Thailand (Sumatra) Tsunami of 2004; Hurricane Hugo (Florida), or Hurricane Katrina (Louisiana).
4. **Government** Research the U.S. health care reform act that was passed in 2010. Prepare a presentation that explains how this act has changed insurance coverage in your family and for the nation. Discuss the benefits as well as the problems and controversies associated with the bill. Prepare and use visual aids during your presentation.
5. **International** Select another country and research its health care laws. Compare the health care and disability coverage options available in the United States and in the other country. Which country's health care laws are more beneficial to patients. Explain why.
6. **Research** Conduct online research about no-fault insurance laws and how they work. List states that have no-fault insurance provisions. Explain what happens when there is an accident in a state with no-fault insurance laws.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7. **Communication** Considering the high cost of insurance premiums, what can you (and your family) do to reduce premiums while maintaining the coverage needed for major risks and serious consequences? Prepare a list titled "Insurance Tips" that addresses the following questions:
   a. How can you reduce premiums by better use of deductibles?
   b. How can you lower premiums by changing your driving habits?
   c. What other strategies can you use to get the most from the money you spend on insurance?
8. **Ethics** Filing a false insurance claim is also known as *insurance fraud*. For example, it would be fraudulent to claim a loss of an item that was not actually in your home when it caught on fire. It is important to note that all insurance companies have insurance investigators who are experts at determining whether or not an item was destroyed by fire. Discuss why it is important for property owners to be truthful and accurate in reporting their losses. Search the Internet for a recent article about a person or company that committed insurance fraud. Write a brief summary of the article, describing the fraud and the outcome. Be prepared to share your summary with the class.

Take Action

PREPARE A HOME INVENTORY

Once you own property, you should take steps to protect it from loss, theft, and damage. Review the example home inventory shown in Figure 6-3.1 and complete the following activities:

a. Create an inventory similar to Figure 6-3.1 for the items in one room of your home. You can choose the room where most of your personal items are kept or another room, such as the living room or kitchen. Use spreadsheet or database software to create the inventory, if it is available. Be prepared to submit an electronic version as well as a hard-copy version of your inventory.

b. If possible, take pictures of or videotape items in the room to supplement the inventory. Also, include receipts or other verification of the value of the items in your inventory where possible.

c. If your family does not have a complete home inventory, encourage your parents or other adults with whom you live to create one. To help convince others to create a home inventory, prepare a persuasive speech explaining what a home inventory is and why it is important. Also, describe how to make one.

After you complete your home inventory, include a copy of it in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 7

Buying Decisions

7-1 Designing a Buying Plan

7-2 Getting Started with Credit

7-3 Computing the Costs of Credit

Photodisc/Getty Images

Consumers buy products and services every day. Some of those decisions are good ones; some are not. Chapter 7 is about making good buying choices and using credit wisely. Overuse and misuse of credit can lead to many undesirable outcomes. There are many sources of consumer credit. Some sources are relatively inexpensive and easy to use. Other sources are restrictive, expensive, and can lead to financial disaster. High interest rates, fees, penalties, and reduced credit limits are often imposed on those who are rated as poor credit risks. Making the right buying decisions and being smart about using credit can maximize your purchasing power.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Game
Chapter 7 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-1 Designing a Buying Plan

GOALS

- Discuss the results of being financially responsible and financially irresponsible.
- Design a buying plan and discuss how it is evaluated, financed, and implemented.

KEY TERMS

- systematic decision making, p. 220
- financial responsibility, p. 220
- financial irresponsibility, p. 221
- buying plan, p. 222
- criteria, p. 222
- spending limit, p. 223
- rebate, p. 223
- extended warranty, p. 224
- financing options, p. 224

How Can You Be a Responsible Shopper?

systematic decision making the process of making choices that reflect goals by considering all the pros and cons along with the costs

As a consumer, you should shop responsibly to ensure your financial security and freedom. Responsible shopping requires **systematic decision making**, which is the process of making choices that reflect your goals by considering all the pros and cons along with the costs. Systematic decision making requires you to be financially responsible.

FINANCIAL RESPONSIBILITY

financial responsibility being able to meet your financial goals through planned earning, spending, and saving

During your lifetime, you will earn and spend a lot of money. **Financial responsibility** occurs when you plan your earning, spending, and saving so that you meet your financial goals. People who are financially responsible are able to:

- live a comfortable lifestyle
- provide for their own wants and needs
- enjoy vacations and leisure time
- save money for known and unknown future events
- pursue interests, hobbies, and cultural events

Financially responsible people of all ages understand the deeply rewarding feeling of being independent and able to take care of themselves. In other words, they are not dependent on others but have learned how to manage their resources so that they are able to pay their own way in life.

Being financially responsible means that you buy goods and services in a responsible manner. Your month's paychecks last the whole month. You don't owe money to others or have to borrow money every time something unexpected happens. You are content and satisfied with the lifestyle that your income is able to provide you. When you are financially responsible, you are able to make payments as agreed and honor your commitments. Your life is structured around sound financial goals that you have set for yourself.

Financial responsibility does not mean life will always be easy or happy or that you will never make mistakes. Everyone makes mistakes. The important thing is that you are able to learn from your mistakes.

When you are financially responsible as a single person, you are able to meet your own needs by carefully managing your resources. When you

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Lisa F. Young, 2010/Used under license from Shutterstock.com

What does it mean to assume responsibility for your own earning, spending, and saving?

get married, you take on additional responsibility. You must consider another person's well-being besides your own. When a couple has children, they are financially responsible for the well-being of the entire family. This type of responsibility should not be taken lightly. Being financially responsible over your lifetime requires planning. The rewards of financial responsibility are satisfaction, independence, and financial freedom.

FINANCIAL IRRESPONSIBILITY

Financial irresponsibility is failing to live up to your financial obligations to meet your goals and needs. When people fail to take responsibility, they are unable to sustain their own lifestyle. Financial irresponsibility symptoms include the following:

financial irresponsibility failing to live up to your financial obligations to meet your goals and needs

- Bills are not paid in a timely manner.
- There is inadequate food, clothing, and shelter to live a comfortable lifestyle.
- Money is spent on luxury items while basic needs are not being met.
- A month's paychecks do not last the entire month.
- Borrowed money is not repaid in a timely manner or at all.

When individuals or families are unable to meet their needs, the costs are high, often unpredictable, and usually overwhelming. Costs of financial irresponsibility include an unhealthy lifestyle/poor health, lack of recreation and fun, and stress and pressure that often lead to poor family relationships. This happens to people in all income groups. Making good choices begins with using systematic decision making, which can be used to set up a buying plan.

CHECKPOINT

What are the benefits of being financially responsible?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Is a Buying Plan?

buying plan an organized method for making good buying decisions

A **buying plan** is an organized method for making good buying decisions. It will help you stretch your limited resources. It will also help prevent *buyer's remorse*, which is regret over a buying decision you have made. When you make a major purchase or spend a large sum of money, a buying plan can aid in the decision-making process. A buying plan is a more detailed extension of a budget.

CREATING A BUYING PLAN

A buying plan, as shown in Figure 7-1.1, is a five-step process that outlines what it is that you are hoping to achieve. By clearly defining the steps, you will be able to choose wisely.

Step 1 Define Your Spending Goal

Items you buy should be selected to meet your wants and needs. By evaluating your wants and needs before you shop, you will be better prepared to make good buying decisions. Because your resources will likely be limited, you should consider the opportunity cost of the item. *Opportunity cost* is the value of what you give up when you make a choice. What other items must you forego buying in order to buy this item? Consider how the item relates to meeting the goals you have set in your budget or financial plan.

Step 2 Choose the Item to Buy

Once you have defined your spending goal, you can then choose items that will meet your goals. This may include new or used, high-quality, or high-, medium-, or low-cost choices. You may also consider renting instead of buying.

Step 3 Define Criteria

criteria standards or rules by which something is judged

Once you have decided to buy a good or service, you should set criteria for the item. **Criteria** are standards or rules by which something can be judged. For an item you want to purchase, the criteria would be the desired features, functions, and quality of the item. List the criteria that you would consider acceptable before you shop for the item.

Figure 7-1.1 Buying Plan

Spending Goal	Item	Criteria	Timeline	Spending Limit
1. Define your need, want, or spending goal.	2. List the item(s) that will satisfy your goal.	3. Describe the features or items that represent an ideal choice.	4. Identify when your goal should be met.	5. Set an upper limit on how much you can or are willing to spend.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Step 4 Set a Timeline

For each item you want to buy, decide how soon you want to make the purchase. The *timeline* sets the time frame for making your decision. It may depend on some activity, such as buying a new dress for graduation. It could also depend on the actions of others. For example, you may wait to buy a particular item until a store places the item on sale. Putting a time frame on each planned purchase will help you prioritize. By waiting a day or more, you may decide not to make the purchase.

Step 5 Set a Spending Limit

A **spending limit** is the maximum amount you are willing to pay for an item. Based on the need or want that is being met, how much money are you willing and able to spend? By setting a spending limit, you will not be tempted to spend more than you have planned.

spending limit the maximum amount you are willing to pay for an item

Figure 7-1.2 is an example of a buying plan to buy a washer and dryer.

IMPLEMENTING A BUYING PLAN

When you know what type of item or service you need to buy and how much you are willing to spend, you can start to gather specific information. You will want to know what products and services are available, along with their features and prices. You may find that you need to revise your spending plan. For example, you may learn that a product with the specific features you want is not available within your spending limit. You must change either the criteria or the spending limit.

Comparison Shopping

Comparison shopping leads to better buying decisions. You can make a better choice when you know all of the options available. Check several sources to find data on prices and features of the product or service. You may find that some items are on sale or offer rebates. A **rebate** is a refund of part of the purchase price of an item. You may also find a wide range of features available. The Internet is useful for product research.

rebate a refund of part of the purchase price of an item

Figure 7-1.2 Buying Plan for a Washer and Dryer

Spending Goal	Item	Criteria	Timeline	Spending Limit
To wash clothes at home rather than at a laundromat (saving time and money)	Washer and dryer (new or used)	Washer should be heavy-duty, have cycles for different kinds of clothes, and have a bleach dispenser. Dryer should be electric (not gas) and have several heat settings.	1 year or sooner	$750

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

You can browse sites containing product data at your own convenience and without any pressure to buy.

Compare the product or service features to the criteria you have set. Determine which product or service has all the features and the quality you need at the lowest price. Remember to add taxes, handling charges, and shipping fees when considering the total cost. Some catalog and Internet companies offer free shipping. Also, you may not have to pay sales tax on items purchased by catalog or on the Internet.

Be aware that the lowest price is not always the best price. Compare the warranties and return policies from the various sellers. For expensive items, having a good *warranty* that protects you against product defects can be an important criterion. Is an extended warranty available? An **extended warranty** is additional coverage that you can buy to pay for repairs or replacements needed beyond the original warranty period.

extended warranty additional coverage that you can buy to pay for repairs or replacements needed beyond the original warranty period

Consider the seller. Is the seller a reputable and established company? Be wary of buying at low prices from a seller you are unable to research. If the item is damaged or of poor quality, the seller may not allow a return or refund.

©Andresr, 2010/Used under license from Shutterstock.com

Why should you consider payment methods as part of your buying plan?

Payment Methods

Each purchase involves two choices—what to buy and how you will pay for it. Sometimes your only payment option is cash. At other times, you can choose among payment methods. You may be able to write a check or pay with a debit or credit card. Each payment method offers benefits. Using a credit card provides protection if you have a problem with the item purchased and want to dispute the charge. Using cash can help prevent overspending.

Knowing in advance how you will pay for a product or service puts you in a better position to bargain. Some merchants will sell a product or service at a lower price if you pay cash. For some items, such as a car, you may borrow money to pay for the purchase. **Financing options** are ways you can pay for an item other than with cash. Always compare financing options offered by the seller and other sources.

financing options ways you can pay for an item other than with cash

Making the Purchase

Consider all the information you have gathered and choose a product or service. Once you have decided on the product or service that will best meet your needs, it is time to buy. Check the item carefully to be sure it is in good condition. If the item is in a box, the box should be sealed. It should be clear that the box was not opened before and resealed. If the box has been resealed, take the item out and examine it.

Ask about warranties and return policies. Be sure to keep the receipt. Know the time period within which a product can be exchanged or returned should you find something wrong with it. Sometimes delivery will cost extra. You might be able to save money by picking up a product yourself.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

INFORMAL SPEAKING

The purpose of *informal speaking* is to share information. Informal speaking often involves getting responses from others. Information is both given and received as other people interact with the speaker. Talking with another person and speaking with several people in a meeting or other group setting are examples of informal speaking. Follow these guidelines to help you communicate effectively in such situations:

- Express your ideas clearly. Do not assume that others will know as much about the topic as you do.
- Speak clearly. Do not mumble or slur sounds. For example, say *nothing* instead of *nothin'*.
- Use standard English. For example, say *give me* instead of *gimme*.
- Use proper grammar. For example, say *she does not* instead of *she don't*.
- Use an appropriate tone. Tone is a manner of speaking that expresses your attitude or feelings. Make the tone of your voice match the topic being discussed. For example, use a light, friendly tone when talking about plans for an upcoming celebration. Use a more serious tone when discussing problems or serious issues.
- Speak at an appropriate volume level. Talk loudly enough to be heard but not so loud as to be annoying.
- Listen to others and give them time to respond.

Try It Out

Gather with a group of your friends. Be prepared to share information with them about the importance of having a buying plan before shopping. Follow the procedures outlined above. Then assess how the group reacted. Did anyone ask you questions? Describe their facial expressions (nonverbal feedback). What did you do well (did they understand what you were trying to say)? What would you do differently?

Evaluating the Purchase

Once you get the product or service and try it out, you may feel differently about it. The excitement of buying is now gone. Ask yourself how satisfied you are with the purchase. Did you follow a buying plan? Did you get good value for the money you spent? Does the product or service meet the want or need for which you purchased it? Are there ways you could have done a better job in selecting or buying? If you had it to do over again, would you still purchase this item? This process will allow you to learn from each buying experience so you can continue to make good buying decisions. Remember, sometimes the right decision is not buying!

CHECKPOINT

What are the five steps of creating a buying plan?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. An organized method for making good buying decisions

_____ 2. The maximum amount you are willing to spend for an item

_____ 3. Being able to meet your financial goals through planned earning, spending, and saving

_____ 4. Standards or rules by which something is judged

_____ 5. Making choices that reflect goals by considering all the pros and cons along with the costs

_____ 6. A refund of part of the purchase price of an item

_____ 7. Failing to live up to your financial obligations to meet your goals and needs

_____ 8. Ways you can pay for an item other than with cash

a. buying plan
b. criteria
c. extended warranty
d. financial irresponsibility
e. financial responsibility
f. financing options
g. rebate
h. spending limit
i. systematic decision making

CHECK YOUR UNDERSTANDING

9. Describe traits of a person who is financially responsible.
10. When people are living beyond their means, they are said to be financially irresponsible. Explain.
11. How is the financial responsibility of a single person different from the financial responsibility of someone who has a family (dependents)?
12. Describe the symptoms experienced by someone who is financially irresponsible.
13. What are the advantages of using a buying plan?
14. Why is it important to set a spending limit before you go shopping for an item?
15. How does a rebate affect the price of an item you are purchasing?
16. Why is the best price not necessarily the lowest price?
17. Under what circumstances would you buy an extended warranty?
18. What payment methods are available when making a purchase?
19. Why is it important to evaluate your purchases?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is it important for you to be financially responsible at this point in your life? How do you plan to be financially responsible throughout your life? (Give examples of what you will do.)
21. Why is systematic decision making important for a person who has a family (dependents)? How could a family use systematic decision making to choose among alternatives when shopping?
22. What are the costs of financial irresponsibility? Why do people who do not take financial responsibility seriously incur these costs?
23. Why is opportunity cost an important factor in a buying plan?
24. Why is it important to set a timeline when planning a purchase? Is it ever a good idea to wait overnight before making a commitment to make a large purchase?
25. Why might you choose to use a credit card for a purchase rather than paying cash? Why might you choose to use cash?
26. Would you choose a product that came with a warranty over a similar product that had no warranty? Why or why not? What is the value of an extended warranty when purchasing an appliance or computer?

EXTEND YOUR LEARNING

27. In this activity, you will make a buying plan. Begin by creating a table with five columns and four rows with the headings shown below. Follow Exhibit 7-1.2 as an example.

Spending Goal	Item	Criteria	Timeline	Spending Limit

    a. Identify three needs or wants for which you would like to purchase items or services. List them in the Spending Goal column.
    b. Identify items or services that would fill each need or want. List them in the Item column.
    c. Identify the criteria that are important for each item or service. List them in the Criteria column.
    d. Set a time frame in which you want to make each purchase. List the time frames in the Timeline column.
    e. Determine the maximum price you are willing and able to pay for each purchase? List the prices in the Spending Limit column.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-2 Getting Started with Credit

GOALS

- Compare the sources of credit.
- List and explain the benefits of credit.

KEY TERMS

- credit, p. 228
- service credit, p. 228
- credit card, p. 229
- revolving credit, p. 229
- store account, p. 229
- installment credit, p. 229
- charge card, p. 229
- consumer loan, p. 230
- collateral, p. 230
- line of credit, p. 230

Where Can Consumers Get Credit?

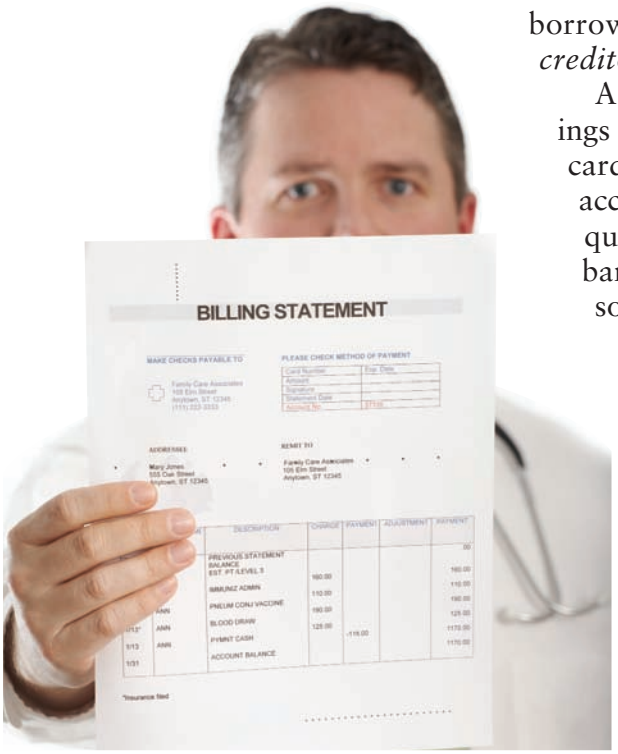
credit the ability to borrow money and pay it back later

service credit the ability to receive services and pay for them later

Credit is the ability to borrow money and pay it back later. The repayment usually includes interest. The purpose of credit is to allow buyers to purchase items and pay for them in the future. Several sources of credit are available to consumers. The person who borrows money is called a *debtor*. The lender is called the *creditor*.

A good way to get started with credit is to open a savings or checking account and get an ATM card and a debit card. When you have proven that you can manage those accounts and have a steady source of income, you will qualify for a credit card. If you use credit responsibly, banks and other companies often offer to provide other sources or types of credit.

When you apply for most forms of credit, you will need to fill out a credit application. The application will ask for your name, address, and social security number. You will also be asked questions such as where you work, how much you make, and how long you have worked there. The creditor must determine that you are creditworthy.



What is service credit?

SERVICE CREDIT

Service credit is the ability to receive services and pay for them later. Examples of service credit include the use of electricity, water, sewer, and other utilities. You may also receive service credit from doctors, dentists, and others. Although you may not think of this as credit, you are receiving services now and paying for them later when you receive a bill. Some companies that offer service credit require you to pay a deposit before you begin using the service. After a good payment record is established, the deposit is often refunded to you.

©Andre Blais, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CREDIT CARDS

A **credit card** is a plastic card linked to a credit account that can be used to make purchases. Credit cards are available from banks and other companies and are usually issued through a provider such as VISA® or MasterCard®. With a credit card, you can buy products or get cash at ATMs around the world.

credit card plastic card linked to a credit account that can be used to make purchases

Bank credit cards are a type of revolving credit. With **revolving credit**, the account holder can charge to the account repeatedly up to a maximum limit. The account holder makes payments, usually each month. The entire debt or part of the debt can be paid each month. The account can have an ongoing balance, but a minimum monthly payment is usually required. Interest is charged on outstanding balances. Interest on credit cards can be quite high. Credit cards also may charge an annual fee.

revolving credit an account on which the account holder can charge repeatedly up to a maximum limit

STORE ACCOUNTS

Department stores, gas companies, and other retail merchants may offer their own credit accounts. The account holder may receive a store credit card to use in making purchases. Unlike a credit card, a **store account** allows you to charge items or services only at that store or with that merchant. Store accounts often have high interest rates and require monthly payments. Using store accounts can result in less comparison shopping because people tend to buy where they have accounts.

store account a credit account that allows you to charge items or services only at that store or with that merchant

Store accounts can be revolving credit accounts, or they can be installment plans. **Installment credit** is used to finance a single high-priced item through a series of equal payments made over a set period of time. For example, a customer might buy a refrigerator for $1,200 and agree to pay 16 percent yearly interest on a three-year payment plan. Figure 7-2.1 shows the payments and interest for this plan.

installment credit credit used to finance a single high-priced item through a series of equal payments made over a set period of time

CHARGE CARDS

A **charge card** is a form of credit card for which you must pay the balance in full each month. Because there is no interest or service fee, these cards often require a large annual fee ($50 to $100 or more). Examples of charge cards are American Express® and Diners Club®.

charge card a form of credit card where the balance must be paid in full each month

Figure 7-2.1 Installment Payment Plan

Amount borrowed	$1,200.00
Annual rate of interest	16%
Number of monthly payments	36
Amount of monthly payment (including both principal and interest)	$42.19
Total amount to be repaid (36 payments of $42.19)	$1,518.84
Total interest paid for the loan	$318.84

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©mangostock, 2010/Used under license from Shutterstock.com

How will you finance your first large purchase, such as a car?

CONSUMER LOANS

consumer loan a direct loan of cash made to a consumer at a fixed interest rate for a set period of time

Banks and other companies loan money to consumers. Consumers can get different types of loans. A **consumer loan** is a direct loan of cash made to a consumer at a fixed interest rate for a set period of time. It is similar to installment credit. For example, a consumer might borrow $1,000 at 8 percent interest for one year. The consumer (debtor) is required to make regular payments for a set period of time to repay the loan.

A single-payment loan also involves a set amount borrowed at a fixed interest rate for a set period of time. With this type of loan, however, the entire amount plus interest is repaid in one payment on a certain date.

The terms of some loans may allow the consumer to use the money borrowed as desired. Other loans may specify how the money is to be used. For example, the loan may be for home repairs or for the purchase of a car.

collateral property used as security for a loan

The lender may require the borrower to offer security for the loan. Property that can be used as security for a loan is called **collateral**. Land, a house, and a car are examples of items that can be used as collateral. Secured loans usually have lower interest rates because the risk to the lender is lower. If the borrower does not repay the loan, the lender may take possession of the collateral and sell it to get the money owed.

If the borrower does not have collateral to offer as security, the lender may require that the loan have a cosigner. A *cosigner* is a person who signs a loan agreement with the borrower and agrees to repay the loan if the borrower does not make the payments. The cosigner must have an established good credit record.

LINES OF CREDIT

line of credit a preapproved loan amount that a debtor can borrow against, pay back, and borrow again as needed

A **line of credit** is a preapproved loan amount that a debtor can borrow against, pay back, and borrow again as needed. It is available through banks, credit card companies, and other lenders. With a line of credit, the maximum amount that can be borrowed is set so you will know how much you have available to finance a purchase. It allows you the flexibility of knowing that you have credit on hand in case you need it. No interest is charged on the unused portion of the line of credit.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

WHAT'S IN A CREDIT REPORT?

A *credit report* is a statement of your credit history issued by a credit bureau. It is a complete record of your borrowing and repayment performance. This record provides a basis of your creditworthiness and helps creditors determine your ability to pay new debt. Based on your credit report, you can be granted or denied new credit. You also can be re-evaluated for a credit limit increase (or decrease).

Every person who uses credit has a credit report on file at a credit bureau. A *credit bureau* is a business that gathers, stores, and sells credit information to business members. Maintaining these files is big business. About once a month, business members transmit data about your credit borrowing and payments to one of the following three national credit bureaus:

- TransUnion (www.transunion.com)
- Experian (www.experian.com)
- Equifax (www.equifax.com)

The credit bureau enters the data into your file and stores it under your social security number. Local and regional credit bureaus hook into the "Big Three's" computer networks, making everyone's information widely accessible.

You have a right to see your credit report, although you may be charged to get a copy of it. When you are denied credit, you have 30 days to request a free report. You can challenge information that you believe is incorrect. The error must be corrected if you can prove it is wrong. You must write a letter explaining the error and providing evidence. Even if the Bureau decides the file information is correct, it must keep your letter of explanation and issue it along with the credit report. Your current debts and payment records are kept as long as there is a balance. Information about your closed accounts is kept for three years, except in the case of bankruptcy, foreclosure, or repossession, which is kept for ten years. It is recommended that consumers check their reports at least once a year to make sure information is correct.

Information in your credit report can affect your financial future. Authorized users of your credit report include more than potential creditors. Employers, banks, insurance companies, landlords, investigators, and others are able to access your credit report to help them decide whether to do business with you. A credit report provides evidence of your financial responsibility—or lack of it!

Think Critically

1. Do you believe that credit bureaus have too much power, since they can gather information about you, sell it, and use it without your knowledge or consent? Why or why not?
2. What can you do to protect your credit report from containing information that could be harmful to you?

Small business owners rely on their lines of credit when they need to make an investment in equipment or complete a new project. Their line of credit allows them to act quickly on decisions. This is necessary because of the competitive nature of business. If a business cannot act quickly, its competitors will likely beat it to the market with a new or improved product or service.

CHECKPOINT ▸ ▸ ▸

How is store credit different from a bank credit card?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Are the Benefits of Credit?

People use credit for a variety of reasons. Using credit provides many benefits, including convenience, increased spending power, and extra protections.

CONVENIENCE AND REWARDS

Credit cards and store accounts offer convenience to consumers. Many people prefer to use credit cards for purchases instead of carrying large amounts of cash. Many companies to which consumers make regular payments accept credit cards. The account can be set up to be billed automatically to a credit card each month. Utility companies and Internet service providers are examples of businesses that offer this option, and some businesses even require it. Paying one credit card bill each month is more convenient than paying several bills from different companies. Consumers can also use some credit cards to get a *cash advance*, which is money borrowed against the credit card. This is convenient for consumers traveling far from home.

Many bank credit cards and store accounts have *rewards features*. With a rewards program, you get points or other bonuses, such as cash back, when you use the card. Points can be redeemed for merchandise or other goods or services. Many stores offer special discounts to store card users.

INCREASED SPENDING POWER

Without credit, many people would have a lower standard of living. They would have to wait to buy things that could save them time and money. For example, a consumer might have to save money for a year to buy a washer and dryer. By using credit, the consumer can purchase the washer and dryer when needed. A small down payment might be required. The remaining cost, along with interest, can be repaid over the course of a year or two. During this time, the consumer is able to use the washer and dryer, saving the time and expense of driving to a laundromat.

Using credit allows some people to buy expensive items that they might never save enough money to pay for all at once. For example, many people do not have enough money to pay the full purchase price of a house. Having a home loan, called a mortgage, allows these people to buy a home.

RECORDS AND PROTECTION

Credit card receipts and your monthly statement provide you with a record of your spending. You can use receipts for returning goods, as well as getting adjustments. Having the receipts also allows you to verify your purchases against the credit card statement.

Using credit gives you advantages when resolving some disputes with merchants. For example, suppose you purchased an item on the Internet. The seller states that you can expect delivery within two weeks. Five weeks pass, however, and you have not received the item. When your credit card bill arrives, you find you have been charged for the item. Because you have used a credit card as payment, you can dispute the charge with your credit card company. The credit card company must resolve the dispute within a certain time period. You can withhold payment of the disputed amount during the investigation.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

MANAGING YOUR CREDIT SCORE

Your credit score, also known as your FICO, is compiled on a point system. FICO stands for Fair Isaac Corporation, the group that designed the credit scoring system. As your credit information changes, your score will reflect these changes. Your credit scores may be different at each of the Big Three credit bureaus because of varying information collected and differences in applying the credit rating system.

FICO scores are calculated on five categories: payment history (35 percent); amounts owed (30 percent); length of credit history (15 percent); new credit from recently opened accounts (10 percent), and types of credit used (10 percent). As you can see, payment history carries the most weight. This refers to how well you pay your debts as agreed. Any liens, collections, or past-due accounts will greatly affect your score in a negative way. The amounts you owe in proportion to your credit limits is another important factor. For example, if your credit limit is $1,000 and your balance is $750, you are using 75 percent of your available credit. This would adversely affect your score. You should try to keep your credit usage at 50 percent or less of credit available.

An excellent FICO score is in the 700–850 range. A very good score is in the 600s (this is often the minimum range to get a mortgage loan). Average scores are in the 500s. Below 500 often means lack of credit or poor credit. It should be noted that these range values change from time to time.

To improve your FICO score, you should pay your debts promptly—on or before the due date. Pay more than the minimum. Reduce your outstanding credit (amounts owed) compared to total credit available. Don't apply for more than one account at a time (new credit lowers your overall score). Keep a good mix of credit types, such as credit accounts, credit cards, installment loans, and mortgages. Too much revolving credit will count against you. And finally, check your credit report on a regular basis to make sure that it contains correct information. Incorrect information can result in rejected credit applications or less-favorable credit terms, such as a higher interest rate.

Think Critically

1. Why should you be concerned about your FICO score even if you aren't planning to apply for credit any time soon?
2. What can you do to get a good FICO score?

Some credit card companies offer various benefits or protections against risks, such as the following:

- You pay no charges for any fraudulent use of the card. You do not have to pay for any purchases made without your knowledge.
- You can withhold payment for disputed items while the dispute is being investigated.
- If a store refuses to refund the price of a returned item within 90 days of purchase, the credit card company will refund the purchase price up to a dollar limit (such as $500) per eligible item.
- If goods are damaged or stolen within 90 days of purchase, the credit card company will replace or refund eligible items.
- You can receive an emergency replacement for a lost card quickly, often within 24 hours.

CHECKPOINT

How can credit improve your standard of living?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The ability to receive services and pay for them later

_____ 2. Property used as security for a loan

_____ 3. A credit account that allows you to charge items or services only at that store or with that merchant

_____ 4. The ability to borrow money and pay it back later

_____ 5. An account on which you can charge purchases repeatedly up to a maximum limit

_____ 6. A form of credit card where the balance must be paid in full each month

_____ 7. A plastic card linked to a credit account that can be used for making purchases

_____ 8. A direct loan of cash made to a consumer at a fixed interest rate for a set period of time

_____ 9. Credit that finances the purchase of a single high-priced item through a series of equal payments made over a period of time

a. charge card
b. collateral
c. consumer loan
d. credit
e. credit card
f. installment credit
g. line of credit
h. revolving credit
i. service credit
j. store account

CHECK YOUR UNDERSTANDING

10. What is the purpose of using credit?
11. List several sources of consumer credit.
12. What types of information are contained in your credit report?
13. How are credit cards different from charge cards?
14. How is a single-payment loan similar to an installment loan? How is it different?
15. Give two examples of collateral that might be used to secure a loan.
16. What is the responsibility of a cosigner on a loan?
17. How is a line of credit different from other types of loans?
18. What is a FICO score?
19. List several benefits of using credit.
20. In what ways do credit cards offer convenience to consumers?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why is it important for you to be financially responsible in the payment of your credit obligations? What will happen if you aren't responsible?
22. Why is the interest rate on a consumer loan for the purchase of a high-priced item, such as a car, generally lower than the interest rate for a small charge on a credit card?
23. Why is a line of credit important to small business owners? How might it be useful to consumers as well?
24. As long as you maintain a good credit record, you will receive many credit offers. The better your credit rating, the better the interest rate you are offered on new accounts. Why is this true?
25. Why should your FICO score be important to you? Suppose you purchase everything with cash and do not use credit. What will happen to your FICO score? Why should you be concerned?
26. Assume an interest rate of 20 percent and a minimum payment of $30 on a credit card balance of $1,000. Using a financial calculator or an online calculator, compare the total cost of reducing the balance to zero by making minimum payments versus making above-minimum payments of $100 a month. Why is it important to pay off credit card debt quickly?
27. Think of the items you own. For each item, identify whether it was purchased with cash or on credit. If it was purchased on credit, give a brief explanation as to what type of credit was used (charge card, credit card, consumer loan, or other) and why.

EXTEND YOUR LEARNING

28. To get a credit card, consumers typically must fill out a credit application. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 7. From the data files, open and print the file *CH07 Credit App*. Practice completing a credit application by entering the following information:
    - Use your name and address. For a home phone use *606-555-1234*. For a business phone use *606-555-0132*.
    - For the date of birth, write *August 1, 1989*.
    - For a social security number, write *000-11-0000*.
    - For an e-mail address, write *myname@provider.com*.
    - For the other items in the Personal Data section, enter fictitious data.
    - For the Employment section, enter fictitious data.
    - In the Other Credit Accounts section, write *Sears store account* in the Type or Name box. Enter *34289-10* for the account number. Enter *$240* for the current balance.
    - In the Bank Accounts section, place a check mark to indicate that you have a checking account. Write the name of a local bank and use the name of your city. For the account number, write *45892-4509*.
    - Sign your name and enter the current date at the bottom of the form.

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-3 Computing the Costs of Credit

GOALS

- Explain credit card rates and methods used for calculating interest.
- Discuss credit card practices and how they affect consumers.
- Discuss how consumers can make wise credit choices.

KEY TERMS

- fixed interest rate, p. 236
- variable interest rate, p. 236
- minimum payment, p. 239
- penalty, p. 240
- over-the-limit fee, p. 240
- cancellation fee, p. 240
- introductory rate, p. 241
- balance transfer, p. 241
- access checks, p. 241
- easy access credit, p. 241

How Is Interest Computed on Credit?

When you carry an ongoing balance on your credit card, you will have to pay interest on your account. Interest and fees you pay are called *finance charges*. These charges increase the cost of the items you purchase with the card. The interest rate affects your monthly payment and how fast you can pay off your balance. Interest charges can be avoided by paying your balance in full each month.

FIXED VERSUS VARIABLE RATES

fixed interest rate interest rate that does not change from month to month

A credit account may have a fixed annual rate of interest. A **fixed interest rate** is set and does not change from month to month. However, even with a fixed rate, the credit card company can, with 30 days' written notice, raise the fixed rate of interest. You can refuse to accept this new rate, but if you do, the company will close your account. When an account is closed, you can pay it off at the old rate, but you can no longer make charges to the account. If you accept the increased rate, it applies only to new charges—not to existing balances.

©Rob Marmion, 2010/Used under license from Shutterstock.com

Why is it important to know the interest rate charged by a credit card company?

variable interest rate interest rate a lender can change at any time without notice

With a **variable interest rate**, the lender or credit card company can change it at any time without notice. Variable rates tend to rise fast when interest rates in general are rising. However, rates tend to go down very slowly. Credit cards with variable interest rates should be used sparingly. You do not want to get caught with a large balance when interest

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 7-3.1 Credit Card Statement (partial)

Summary of Transactions

Previous Balance	Payments and Credits	Cash Advances	Purchases and Adjustments	Finance Charges	New Balance Total
$2,102.42	$2,144.81	$0.00	$1,259.61	$0.00	$1,217.22

Finance Charge Schedule

Category	Periodic Rate	Corresponding Annual Rate	Balance Subject to Finance Charge
Cash Advances			
A. Balance Transfers, Checks	0.043753% Daily	15.97%	$0.00
B. ATM, Bank	0.043753% Daily	15.97%	$0.00
C. Purchases	0.043753% Daily	15.97%	$0.00

Total Minimum Payment Due

Past Due Amount	Current Payment	Total Minimum Payment Due
$0.00	$15.00	$15.00

rates are rising. It is typically better to choose a card with a fixed rate instead of a card with a variable rate.

Your credit card statement must disclose to you the daily rate of interest, the annual rate, and how it is applied to your balances. It will also show the due date for your payment. Figure 7-3.1 shows a portion of a credit card statement.

METHODS OF COMPUTING INTEREST

Three basic methods are used to compute interest on revolving credit accounts: the adjusted balance method, the previous balance method, and the average daily balance method. Most creditors use one of these or a similar method. Different interest charges can result with each method.

NETBookmark

More than 50 million people have a Discover card. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 7. Click on *Credit Cards* and then *Browse All Discover Credit Cards* and read about the different cards Discover offers. Why do you think Discover offers so many different types of credit cards? Which do you think would best suit your needs? Why?

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 7-3.2 Adjusted Balance Method

Previous Balance		$500.00
Charges:	$30.00	
	50.00	
	80.00	
Total Charges		160.00
Payment		−100.00
Adjusted Balance		$560.00
Interest for 1 Month (18% Yearly): $560 × 18% × 30/360		8.40
New Balance (Amount Owed)		$568.40

Adjusted Balance Method

With the *adjusted balance method*, the interest is calculated based on the amount owed after you have paid your bill each month. The charges made during the period are added to the balance at the beginning of the period. The payment received is subtracted from this amount to find the adjusted balance. The interest is calculated using the formula Principal (P) × Rate (R) × Time (T). In this case, the adjusted balance is the principal. (In most transactions, the standard practice is to use 360 as the number of days in a year for computing interest.) The interest amount is added to the adjusted balance to find the new balance (amount owed), as shown in Figure 7-3.2.

Previous Balance Method

With the *previous balance method*, interest is calculated based on the outstanding balance at the end of the previous billing period. Charges and payments in the current billing period are not included. The new balance is the previous balance plus interest and charges and minus any payments made, as shown in Figure 7-3.3.

Average Daily Balance Method

With the *average daily balance method*, an adjusted balance is computed for each day of the month. The adjusted balance is the balance from the previous day plus charges and minus payments received on that day. The adjusted balances for all days are added and then divided by the number of days. This amount is the average daily balance. Interest is calculated

Figure 7-3.3 Previous Balance Method

Previous Balance		$500.00
Interest for 1 Month (18% Yearly): $500 × 18% × 30/360		7.50
Charges:	$30.00	
	50.00	
	80.00	
Total Charges		160.00
Payment		−100.00
New Balance (Amount Owed)		$567.50

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 7-3.4 Average Daily Balance Method

Previous Balance $500.00

Daily Balances:

	Previous Balance	Charges	Payments	Adjusted Balance
Day 1	$500.00	$0.00	$0.00	$500.00
Day 2	$500.00	$0.00	$0.00	$500.00
Day 3	$500.00	$0.00	$0.00	$500.00
Day 4	$500.00	$30.00	$0.00	$530.00
Day 5	$530.00	$0.00	$0.00	$530.00
.				
.				
.				
Day 25	$660.00	$0.00	$100.00	$560.00
Day 26	$560.00	$0.00	$0.00	$560.00
Day 27	$560.00	$0.00	$0.00	$560.00
Day 28	$560.00	$0.00	$0.00	$560.00
Day 29	$560.00	$0.00	$0.00	$560.00
Day 30	$560.00	$0.00	$0.00	$560.00

Average Daily Balance	$563.67
Interest for 1 Month (18% Yearly): $563.67 × 18% × 30/360	8.46
New Balance (Amount Owed): $560.00 + $8.46	$568.46

based on the average daily balance. The interest is added to the balance on the last day of the billing period to find the new balance, as shown in Figure 7-3.4.

CHECKPOINT

Why is a fixed rate better than a variable rate?

What Are Common Credit Policies?

When credit is extended, there often is a credit agreement outlining the terms and conditions that must be met by the creditor and debtor. Consumers should be aware of the various credit policies that are a part of the credit agreement.

MINIMUM PAYMENTS

The **minimum payment** is how much you are required to pay each month on a credit account. If you pay only the minimum, it could take many years to pay off a balance. The interest charges could cost you more than the purchase itself. Thus, it is always better to pay more than the minimum payment if possible.

minimum payment the amount you are required to pay each month on a credit account

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Minimum payments usually are 3 to 5 percent of the balance owed. Thus, if you owe $1,000, your monthly payment would be $30 to $50. This payment includes both principal and interest. Higher minimum payments help you pay off debt sooner. However, higher payments also give you less flexibility in managing your monthly budget.

The minimum payment can be changed at any time. The creditor may decide to increase the minimum payment, and you will have to pay that amount. This could be difficult if your budget is already tight.

PENALTIES AND FEES

penalty a fee charged for violating a term of the credit agreement

You should expect to make regular payments on or before the due date. If you make a late payment, you will typically be charged a penalty. A **penalty** is a fee charged for violating a term of the credit agreement. A late payment penalty is often $35 or more. Late or missed payments can also cause your interest rate to rise. The penalty interest rate could be 25 percent or higher.

Many credit card accounts have a set limit on the amount you can charge. This is called your *credit limit*. If you try to charge more than your limit, the charge may be refused. The credit card company may approve the charge but then charge you an **over-the-limit fee** for exceeding your approved credit limit. You may have to pay the over-the-limit fee every billing period until your outstanding balance falls below your credit limit. This type of penalty can also cause your interest rate to rise.

over-the-limit fee a penalty charged when you exceed your approved credit limit

cancellation fee a penalty for closing your account prior to a stated period

Some credit card agreements have a termination penalty. A **cancellation fee** may be applied if you close the account before a stated time, such as one year. In addition, the credit card company may raise your interest rate to the highest rate allowed by law, often 25 percent or higher. A cancellation fee may apply to credit cards that offer low introductory interest rates. It discourages you from closing the account at the end of the low-rate period. Be aware that penalties and fees of all kinds are reported to credit bureaus and lower your credit score.

INTEREST RATE INCREASES

Credit card issuers can raise your interest rates, even with fixed rate accounts. When they have reason to believe that you are a higher risk, they can give you notice and raise your rate. This may occur if you have too much total credit or if your outstanding credit (amount owed) is high compared to your total credit limit. Rates cannot be raised on existing balances.

LOWERED CREDIT LIMIT

Credit card issuers can lower your credit limit at any time. They may take this action if they believe you have become a greater risk. If this happens, you may be left without enough credit to meet your goals. Thus, it is often to your advantage to have more than one credit card. Keep in mind that if your credit limit is lowered, your credit score may also be lowered.

CHECKPOINT ▸ ▸ ▸

Describe the penalties and fees charged by credit card companies.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Can You Make Wise Credit Choices?

You will be confronted with many choices when using credit. Consider all of your options and evaluate them carefully. If you choose wisely, you can reduce your costs of credit and use credit to your advantage.

SPECIAL OFFERS

A credit card interest rate is expressed as an annual percentage rate (APR). By law, creditors must clearly state the APR on all credit offers. Variable rates are often tied to the prime rate (the interest rate banks charge customers with excellent credit scores). Typically, it is the current prime rate plus some percentage, such as 5 percent.

Some credit card companies offer a low **introductory rate**, which is a temporary interest rate on new accounts. Introductory rates often last six months to a year and are then replaced with variable or fixed rates. The purpose of these rates is to get you to switch to a new credit card. Be cautious, however, because the regular rate may be very high.

introductory rate a low temporary interest rate offered when you open a new account

You may do a **balance transfer** by moving what you owe on an old card to a new card. Interest rates on balance transfers are sometimes 0 percent, but transaction fees for this service may be high. Low rates or fees are offered to entice you to change cards. However, the low rates usually apply only to the transferred balance—not to new charges.

balance transfer moving a balance from one credit card account to another

EASY ACCESS CREDIT

Sometimes credit card companies provide **access checks**, which look like regular checks but are used to borrow money against your credit card account. They are similar to cash advances. When you use an access check to pay off another credit card, basically you are transferring the balance to your new credit card. You may also use them to pay bills or make new purchases. The purchases are charged to your credit card account. This type of credit is a form of **easy access credit**, which can be obtained quickly and easily but often carries high or hidden costs.

access checks checks provided by a credit card company that allow you to borrow against your credit card account

Another type of easy access credit is an *instant credit offer*. You may be making a purchase at a store when the sales associate offers you a discount or other incentive if you sign up for the store's credit card on the spot. It's important to understand the fees and costs associated with the credit card.

easy access credit types of credit that can be obtained quickly and easily but often come with high and hidden costs

Easy access credit is also available at a *payday loan* business where you can get a short-term loan to cover expenses until your next payday. This is simple and fast, but the interest and fees paid can be substantial. Figure 7-3.5 shows how to calculate the annual percentage rate on an easy access payday loan.

ONLINE CREDIT APPROVAL

Today, you can find major creditors—even mortgage lenders—and apply for credit online. In some cases, you can get loan approval in minutes. Online applications require you to provide sensitive personal data, such as your income, social security number, and bank account numbers, so be sure you are using a secure site before giving out this type of information. Avoid credit offers that come to you by e-mail or pop-up ads. They may be scams. Only apply for credit when you initiate the contact.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 7-3.5 Payday Loan

The formula for computing the annual percentage rate of a payday loan is:

Loan fee ÷ Loan amount × Number of days in the year ÷ Loan term in days

If you borrow $350 for two weeks (14 days) and pay a loan fee of $50, the annual percentage rate would be calculated as follows:

$50 ÷ $350 × 360 ÷ 14 = 3.67, or 367% APR

CREDIT CARD STATEMENT

When you receive a credit account statement, check that the charges, payments, interest, fees, and new balance are correct. Follow these steps:

1. Compare the charges listed on the statement with your sales receipts and records of online or telephone purchases, making sure they match.
2. Verify that payments you have made are shown on the statement.
3. Verify that credits (such as for returned items) are listed.
4. Take note of any fees or penalties you have been charged. Determine whether these fees are permitted according to the credit agreement. You can always call and ask to have them removed.
5. Verify that the interest amount and the new balance owed are correct.

If you find errors, contact the credit company. Instructions for reporting errors may be provided on the back of the statement.

GOOD CREDIT PRACTICES

Although using credit has its benefits, it also has disadvantages. Unwise use of credit can lead to overspending. If you make late payments, your interest rates will increase, making it difficult to pay down the balances. Also, your credit rating will suffer.

If you use credit wisely, costs can be kept to a minimum. For example, credit card companies charge interest on outstanding balances. If you pay the full amount owed on your credit card each month, you can avoid paying interest charges. By using this strategy, you can enjoy the benefits of using credit with little cost. However, you may still have to pay an annual fee for the card.

Being aware of your credit card billing cycle is also important. Items you charge at the end of the billing cycle will show up on your bill immediately. If you wait a week, they won't show up until the next month. This gives you more time to save your money and pay the bill in full (and avoid interest charges).

Most credit cards and accounts allow you to view your account online. Keeping track of balances can help you keep your debts in check.

CHECKPOINT ▸ ▸ ▸

Provide examples of easy access credit.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A penalty charged when you exceed your approved credit limit

____ 2. Types of credit that can be obtained quickly and easily but often come with high and hidden costs

____ 3. An interest rate that can change at any time without notice

____ 4. A penalty for closing your account prior to a stated period

____ 5. An interest rate that does not change from month to month

____ 6. Checks provided by a creditor that allow you to borrow money against your credit card account

____ 7. The amount you are required to pay each month on a credit account

____ 8. Moving a balance from one credit card account to another

____ 9. A fee charged for violating a term of the credit agreement

a. access checks
b. balance transfer
c. cancellation fee
d. easy access credit
e. fixed interest rate
f. introductory rate
g. minimum payment
h. over-the-limit fee
i. penalty
j. variable interest rate

CHECK YOUR UNDERSTANDING

10. List some costs associated with using credit.
11. Explain the difference between accounts that have fixed interest rates and those that have variable interest rates.
12. Describe how finance charges (interest) may be computed on credit cards using three common methods.
13. What does the minimum payment amount on a credit card statement indicate?
14. What happens if you don't make your minimum payment as agreed?
15. What is an over-the-limit fee and how can you avoid it?
16. Why do credit card companies offer low introductory rates for purchases and account balance transfers?
17. Why should you avoid online and other unrequested credit offers?
18. What items should you verify when you receive a credit card statement?
19. How can you protect yourself from paying interest and fees on a credit card?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. The Credit Card Act of 2009 required that creditors not raise the interest rate on existing balances when raising fixed rates. How does this work to your advantage?
21. Credit card statements must indicate how long it will take you to pay off your current balance making only minimum payments and provide the total interest you will be charged. How is this information useful to you?
22. Credit card companies can raise the minimum payment required at their discretion. How can this adversely affect a credit card holder?
23. Whenever you exceed your credit limit, make late payments, or fail to make a minimum payment, you can be charged a penalty or fee. When this happens, it is also reported to the credit bureau. Why would this adversely affect your credit rating?
24. Explain the dangers of easy access credit. If you get a payday loan of $500 for two weeks (14 days) for a fee of $100, what is the annual percentage rate? (Hint: Use 360 as the number of days in a year.)

EXTEND YOUR LEARNING

25. Credit card companies offer different rates, fees, penalties, and other terms. Study the two examples of credit card terms that follow. Evaluate these two credit card offers. Which one would you choose? Why?

    Credit Card A: This card has a fixed interest rate of 8.9 percent, an annual fee of $50, and an over-the-limit fee of $50. If you make a late payment, the interest rate rises to 19.99 percent. If you have two or more offenses (such as an over-the-limit fee and a late payment), the interest rate rises to 29.99 percent. This card also has a rewards feature that gives you back 1 percent in cash each year.

    Credit Card B: This card has a variable interest rate of 4.9 percent for one year. After that, the rate is based on the prime rate plus 6 percentage points. It has an over-the-limit fee of $35. If you are late making a payment, the interest rate will rise to 24.9 percent plus the prime rate. This card has no rewards feature, and it has no annual fee.

26. You should check credit statements carefully and compare them to your credit receipts and records. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 7. From the data files, open and print the file *CH07 Statement*. Follow the steps below:
    a. Compare the charges listed on the statement with the list of receipts. Which, if any, amounts are different?
    b. Are any payments that were made shown on the statement? Are any credits (such as returned items) shown on the statement? Are any fees or penalties shown on the statement? If so, what is the reason for them?
    c. Are the interest amount and the new balance (amount owed) correct?
    d. What should you do if you find what you think is a mistake on a credit account statement?

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

CREDIT

When you apply for credit, your application is handled by credit clerks who gather data from your credit history to evaluate the risk and potential rewards of granting you credit. This process may happen entirely online, or you may apply in person, by phone, or by mail with a completed application form.

A lender's credit policies will determine which applications are granted or denied. The economy also affects decisions. Technology is an important part of the efficiency and speed of checking creditworthiness. A computer program can assess and assign a credit score. Most credit clerks will check your credit score and review your credit report to see what kind of customer you are likely to be. Your credit score may be the only consideration, or it may be one of many factors considered. Credit clerks may base the decision on a *rubric*, or a decision model based on acceptable and unacceptable behaviors.

Employment Outlook

- Employment growth will be slower than average through 2018 due to technology improvements.
- Openings will arise as a result of closer attention to credit policies by lenders.

Job Titles

- Credit authorizer
- Credit checker
- Credit clerk
- Account collector
- Loan clerk
- Loan adjuster

Needed Education/Skills

- A high school diploma is required, along with on-the-job training.
- Some college is preferred, especially accounting courses.
- You may be required to be bonded and insured and to become a notary public.

What's it like to work in . . . Credit

Ian is a loan clerk at the local credit union. He receives more than 50 applications a day from credit union members. Most are for the purchase of vehicles, but some are for personal loans and lines of credit.

As part of the approval process, Ian will quickly review the applicants' credit reports. He will also consider their history with the credit union, the balances in their accounts, and their employment status. The credit union tries to accommodate as many members as possible.

Ian will meet with his supervisor at 10 a.m. to go over the approved applications. He will also be prepared to discuss why some loan applications were rejected.

What About You?

Would a job in credit appeal to you? Are you interested in helping people get financing for their cars and other important purchases? Can you be trusted with confidential information? Are you detail-oriented?

©elwynn, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 7 Assessment

SUMMARY

7-1 Being a responsible shopper requires financial responsibility, which involves planning your earning, spending, and saving to meet financial goals. Financial irresponsibility will result in the inability to sustain your own lifestyle.

Designing a buying plan involves defining your spending goal, choosing the item to buy, defining criteria, setting a timeline, and setting a spending limit.

Implementing a buying plan involves comparison shopping, choosing among payment methods, making the purchase, and evaluating the purchase so you can make better choices in the future.

7-2 Credit is the ability to borrow money with the agreement to pay it back later, usually with interest.

Types of credit available to consumers include service credit, credit cards, store accounts, charge cards, consumer loans, and lines of credit.

Using credit has many benefits, including convenience and rewards, increased spending power, spending records, and special protections.

7-3 Interest and fees you pay for the use of credit are called finance charges.

A fixed rate of interest typically does not change from month to month, but it can be raised with proper notice to customers. A variable rate of interest goes up and down at the discretion of the creditor.

Three basic methods are used to compute interest on revolving credit accounts: the adjusted balance method, the previous balance method, and the average daily balance method.

Common credit policies include charging penalties and fees for violating any term of the credit agreement. Violations may also lead to rate increases and reduced credit limits.

Consumers should evaluate special offers carefully and be wary of introductory rates, easy access credit, and unrequested online offers.

Credit card statements should be checked very carefully.

You can enjoy the benefits of credit at low cost if you pay your balance in full each month and time purchases at the start of the billing cycle.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Use spreadsheet software, if available, to complete the problems below, or do them manually. Round to the nearest cent.

Credit Card Activity		
Previous Balance		$800.00
Charges:	September 5	$35.78
	September 18	$124.87
	September 21	$528.00
Payments	September 22	$750.00
Annual Interest Rate	14%	

   a. The table above shows the activity on your credit card for the past month. What is the new balance using the adjusted balance method of computing interest?
   b. Using the same information, what is the new balance using the previous balance method for computing interest?
   c. Using the same information, what is the new balance using the average daily balance method for computing interest?

2. **Research** Comparison shopping leads to better buying decisions. You can make a better choice when you know all of the options available. Assume you are ready to buy a car. Work with two classmates to complete this activity.
   a. Make a list of criteria that the car should have.
   b. Each team member should search the Internet, look at sales brochures, or use other sources to find the following information about two cars from two different sources:
      - car name or brand
      - car make or model number
      - criteria on your list that the car meets
      - price of the car
      - other costs that will apply, such as taxes or added options (for example, a sunroof or a GPS navigation system)
      - car rebates or other special offers
      - car warranty
   c. As a group, compare the information from the two sources. Consider car prices and other charges. Remember that the lowest price is not always the best price. Discuss whether each car meets the criteria you listed. Compare warranties and special offers.
   d. As a group, decide which car you would buy. Explain why.
3. **History** Research credit in America, starting with the 1950s when most households had a single income and credit cards were rare. Write a report, dividing your work into decades and commenting on how and why credit has changed, including the costs of credit.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

4. **Math** Assume you have a credit card balance of $1,000. Your interest rate on the credit card is 18 percent, and your minimum monthly payments are $50. At this rate, how long will it take to pay off your credit card? What would your payment need to be to pay it off in three years? How long would it take to pay off your debt if your interest rate is 14 percent and your minimum monthly payments are $50? Use a financial calculator or an online calculator to do your computations.
5. **Economics** Research the Credit Card Act of 2009 online. Select five regulations set forth by the act. Prepare PowerPoint slides or other visual aids that describe each regulation.
6. **Ethics** Credit card companies regularly assess the risk of their accounts. If they feel your credit standing justifies it, they will cut your credit limit, raise your rate, or even cancel your card. Do you believe new laws should be passed or that a consumer protection agency should be given more power to protect your rights as a user of credit? Explain.

Take Action

EVALUATE CREDIT CARD OFFERS

Credit card offers can vary considerably. Shopping for a credit card involves making decisions similar to those involved in making purchases. You should follow the same steps as in a buying plan. First, think about why you want or need a credit card. Next, consider how you will use it. Set criteria that you want the credit card agreement to meet. Then, do comparison shopping to find the card that most closely matches the criteria you have set.

Assume that you are ready to apply for a credit card. You will use the card to make shopping more convenient. You plan to pay the entire balance each billing period to avoid paying interest charges.

You have also thought about the criteria for the card you want. The card should have a low annual fee ($50 or less) or no annual fee, a reasonable annual interest rate, a low introductory annual interest rate, and a rewards program that interests you.

a. Use the Internet to perform searches using terms such as *low credit rates*, *credit card offer*, or *credit card application*.
b. Visit several websites that provide information about credit card offers. Read the information about fees and interest rates. Find a card that meets your criteria.
c. Choose a card. List its features and describe its rewards program. Explain why you selected this card over other cards you considered.

Save the list of credit card features and your reasons for selecting the credit card in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 8

Preserving Your Credit

8-1 Identifying Financial Issues

8-2 Long-Term Debt Repayment

8-3 Credit Management

©Supri Suharjoto, 2010/Used under license from Shutterstock.com

Individual responsibilities change as you decide to venture out on your own and live as an independent adult. You may choose to live with others, becoming a member of a new household. In doing so, it is important to share goals and resources, to identify responsibilities, and to plan for a harmonious and comfortable lifestyle. While debt is often necessary to have the basic comforts of life, a responsible person will plan for and pay off those debts in a timely manner. Renting and major purchasing decisions must be entered into carefully. In this chapter, you will learn about life planning, communication, and decision making as you move into new living arrangements independent of your parents. You'll also discover how to manage credit in ways that minimize your costs and risks while maximizing the value you receive.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Data File
Key Terms Flashcards
Flash Game
Chapter 8 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-1 Identifying Financial Issues

GOALS

- Discuss living arrangements and financial issues with other members of your household.
- Describe contractual rights and responsibilities for landlords and tenants.

KEY TERMS

- shared responsibility, p. 250
- roommate, p. 250
- living habits, p. 250
- logistics, p. 251
- security deposit, p. 251
- contract, p. 252
- consideration, p. 252
- lease, p. 252
- eviction, p. 254
- property manager, p. 254

What Are Shared Responsibilities?

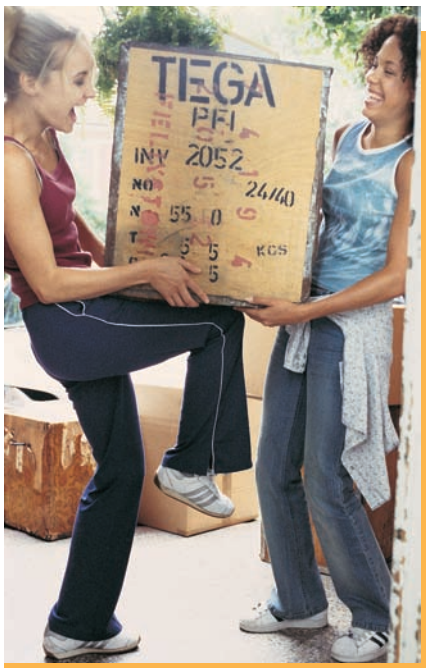
shared responsibility an agreement between two or more people to bear a portion of an obligation

roommate a person with whom you share living space and responsibilities

living habits your daily routine, or the way you choose to live your life

After you leave your parents' home and go to college or move into your own residence, you will likely share physical space and financial resources with one or more other persons. **Shared responsibility** occurs when two or more people each agree to bear a portion of an obligation. For example, if you share an apartment with others, all of you will share the responsibility of paying the rent on time. You must take your responsibilities seriously because any missteps can lead to financial and credit problems.

LIVING ARRANGEMENTS



Digital Vision/Getty Images

How do living habits affect compatibility?

At some point in time, you may choose to live with another person rather than living alone. A **roommate** is a person with whom you share living space and responsibilities. Choosing a roommate (or roommates) carefully will save you the frustration and money involved when an irresponsible roommate does not live up to his or her obligations.

You should reach an agreement in several important areas before you move in with a roommate. **Living habits** describe your daily routine, or the way you choose to live your life. It's important that your living habits are compatible with those of your roommate. Otherwise, you are likely to have immediate and serious difficulties living together. For example, if your roommate has frequent guests, you may feel you have no privacy. Questions to ask before entering into a living arrangement may include the following:

- Do you smoke or drink? How do you feel about those who do?
- Do you like a clean living area at all times or are you more easy-going and casual?
- Do you have a social life that will impose on your roommate? (Do you intend to have frequent visitors?)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- Do you have a source of income, such as a job, to ensure that you can pay your share of the expenses?
- How should the division of household chores be handled? (Who will be responsible for activities such as cooking, cleaning, and maintenance?)
- What are your leisure activities? (What do you like to do in your spare time and how will that affect your roommates?)
- Will you need to share transportation? (How will you and your roommate(s) get to and from work, school, and shopping?)
- What are your future goals? (What do you plan to do in the next few years—continue education, work full time, or travel?)

By discussing these issues, you will know, understand, and appreciate each other's needs, values, and differences. You will have an idea of what it will be like to live together and what each person can expect from the other(s). Reaching an understanding ahead of time will help reduce conflict later.

FINANCIAL ISSUES

When living with a roommate, you should work out the logistics of how rent, utilities, and other joint costs will be paid. **Logistics** is the act of making a plan and carrying it out to ensure that an event takes place.

logistics the act of making a plan and carrying it out to ensure an event takes place

Each roommate has responsibility for his or her proportional share of the costs. Perhaps you and your roommate will agree to pool your money and pay the rent and other expenses from one account. Or, maybe each roommate will pay his or her share on or before the due date, assuming the landlord will accept a separate check from each tenant. If part or all of the rent, utilities, or other joint costs are not paid on time, then all tenants are in jeopardy.

Tenants also typically share in the payment of deposits and fees. A **security deposit** is a refundable amount paid to cover possible damages to property caused by a tenant. You may also have to pay nonrefundable fees, such as for cleaning, changing the locks, or other services. Moving costs include the time and money spent in packing, loading, transporting, unloading, and unpacking. When moving into a new residence, there are often installation charges, such as for cable, Internet, and phone services. You must also arrange to have the electricity and other utilities turned on or transferred to your names, which may require a security deposit and/or fees.

security deposit a refundable amount paid to cover damages to property caused by a tenant

Group budgeting allows for the careful allocation of expenses so that each person pays his or her share. The budget should be prepared and put into writing. It is important for each person to understand and agree to his or her responsibilities. Figure 8-1.1 is an example of a group budget.

It's possible that one person may be responsible for a larger share of the rent, utilities, or other expenses. For example, one roommate may have a much larger bedroom than the others. Another roommate may have a pet, which requires a pet deposit. In these cases, not all of the expenses would be shared equally. The group budget should show the correct division of expenses.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 8-1.1 Group Budget

Expense	Monthly Cost	Robert's Share	Bill's Share	Juan's Share
Rent	$900	$300	$300	$300
Utilities (average)	150	50	50	50
Cable/TV/Internet	90	30	30	30
Gas/insurance/ repairs	120	40	40	40
Groceries	600	200	200	200
Household supplies	90	30	30	30
Totals	$1,950	$650	$650	$650

CHECKPOINT

What are the financial issues that should be agreed upon before moving in with a roommate?

What Are Contractual Rights and Duties?

contract a legally binding agreement that specifies the rights and duties of each party

consideration something of value exchanged for something else of value

During your lifetime, you will enter into many agreements with other individuals and businesses. A **contract** is a legally binding agreement that specifies the rights and duties of each party to the agreement. To be legally binding, a contract requires **consideration**, which is something of value exchanged for something else of value. For example, you may agree to pay money for a couch that the furniture store agrees to deliver to your residence.

Many contracts are oral agreements where you promise to do or give something in exchange for something provided to you. Because oral contracts may be more difficult to enforce, many businesses as well as consumers prefer to put their agreements in writing. For example, if you buy a refrigerator and agree to make monthly payments for 24 months, you will sign an installment contract. The contract will specify dates of payment, interest rate, and so forth. If you fail to make payments as agreed, you also agree that the refrigerator can be repossessed.

As a tenant renting property from a landlord, you (and your roommates) will be entering into a rental agreement or contract. A rental agreement that specifies the rights and duties of the landlord and tenant is known as a **lease**. Figure 8-1.2 is an example of a lease agreement.

lease a rental agreement that specifies the rights and duties of the landlord and tenant

TENANT RIGHTS AND RESPONSIBILITIES

Tenants have the right to possess and enjoy the rented property. They can come and go as they please, have guests, and use the property as a residence. They also have the right to use common areas, such as hallways, lawns, swimming pools, meeting rooms, and other amenities provided on the property.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 8-1.2 Residential Lease Agreement

RESIDENTIAL LEASE AGREEMENT
AND SECURITY DEPOSIT RECEIPT

THIS INDENTURE, made this 29th day of October, 20 --, between Brendan Martin, hereinafter designated the Lessor or Landlord, and Teresa Thomas, hereinafter designated the Lessee,

WITNESSETH: That the said Lessor/Landlord does by these presents lease and demise the residence situated at 614 Dundas Street in Cincinnati City, Hamilton County, Ohio State, of which the real estate is described as follows:

614 Dundas Street, Cincinnati, Ohio,

upon the following terms and conditions:

1. **Term:** The premises are leased for a term of one (1) years, commencing the 1st day of November, 20--, and terminating the 31st day of October, 20--.

2. **Rent:** The Lessee shall pay rent in the amount of $ $600.00 per month for the above premises on the 1st day of each month in advance to Landlord.

3. **Utilities:** Lessee shall pay for service and utilities supplied to the premises, except None which will be furnished by Landlord.

4. **Sublet:** The Lessee agrees not to sublet said premises nor assign this agreement nor any part thereof without the prior written consent of Landlord.

5. **Inspection of Premises:** Lessee agrees that he has made inspection of the premises and accepts the condition of the premises in its present state, and that there are no repairs, changes, or modifications to said premises to be made by the Landlord other than as listed herein.

6. **Lessee Agrees:**
(1) To keep said premises in a clean and sanitary condition;
(2) To properly dispose of rubbish, garbage, and waste in a clean and sanitary manner at reasonable and regular intervals and to assume all costs of extermination and fumigation for infestation caused by Lessee;
(3) To properly use and operate all electrical, gas, heating, plumbing facilities, fixtures, and appliances;
(4) To not intentionally or negligently destroy, deface, damage, impair, or remove any part of the premises, their appurtenances, facilities, equipment, furniture, furnishings, and appliances, nor to permit any member of his family, invitee, licensee, or other person acting under his control to do so;
(5) Not to permit a nuisance or common waste.

7. **Maintenance of Premises:** Lessee agrees to mow and water the grass and lawn, and keep the grass, lawn, flowers, and shrubbery thereon in good order and condition, and to keep the sidewalk surrounding said premises free and clear of all obstructions; to replace in a neat and workmanlike manner all glass and doors broken during occupancy thereof; to use due precaution against freezing of water or waste pipes and stoppage of same in and about said premises and that in case water or waste pipes are frozen or become clogged by reason of neglect of Lessee, the Lessee shall repair the same at his own expense as well as all damage caused thereby.

8. **Alterations:** Lessee agrees not to make alterations or do or cause to be done any painting or wallpapering to said premises without the prior written consent of Landlord.

9. **Use of Premises:** Lessee shall not use said premises for any purpose other than that of a residence and shall not use said premises or any part thereof for any illegal purpose. Lessee agrees to conform to municipal, county and state codes, statutes, ordinances, and regulations concerning the use and occupation of said premises.

10. **Pets and Animals:** Lessee shall not maintain any pets or animals upon the premises without the prior written consent of Landlord.

11. **Access:** Landlord shall have the right to place and maintain "for rent" signs in a conspicuous place on said premises for thirty days prior to the vacation of said premises. Landlord reserves the right of access to the premises for the purpose of:
(a) Inspection;
(b) Repairs, alterations or improvements;
(c) To supply services; or
(d) To exhibit or display the premises to prospective or actual purchasers, mortgagees, tenants, workmen, or contractors. Access shall be at reasonable times except in case of emergency or abandonment.

12. **Surrender of Premises:** In the event of default in payment of any installation of rent or at the expiration of said term of this lease, Lessee will quit and surrender the said premises to Landlord.

13. **Security Deposit:** The Lessee has deposited the sum of $ 600.00, receipt of which is hereby acknowledged, which sum shall be deposited by Landlord in a trust account with Citizens bank; savings and loan association, or licensed escrow, Cincinnati branch, whose address is 201 Main Street, Cincinnati, Ohio
All or a portion of such deposit may be retained by Landlord and a refund of any portion of such deposit is conditioned as follows:
(1) Lessee shall fully perform obligations hereunder and those pursuant to Chapter 207, Laws of 1973, 1st Ex Session or as may be subsequently amended.
(2) Lessee shall occupy said premises for one (1) months or longer from date hereof.
(3) Lessee shall clean and restore said residence and return the same to Landlord in its initial condition, except for reasonable wear and tear, upon the termination of this tenancy and vacation of apartment.
(4) Lessee shall have remedied or repaired any damage to apartment premises.
(5) Lessee shall surrender to Landlord the keys to premises.
Any refund from security deposit, as by itemized statement shown to be due to Lessee, shall be returned to Lessee within fourteen (14) days after termination of this tenancy and vacation of the premises.

IN WITNESS WHEREOF, the Lessee has hereunto set his hand and seal the day and year first above written.

/s/ Brendan Martin
LANDLORD

/s/ Teresa Thomas
LESSEE

610 Dundas Street
Cincinnati, Ohio
ADDRESS

(Acknowledgment)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Tenants also have responsibilities. They must use the property only for the purpose for which it was intended, take proper care of the property, report any needed repairs in a timely manner, and give the landlord access to the property as needed for repairs and maintenance. They must obey the rules specified in the rental agreement and respect the rights of other tenants and neighbors. For example, some agreements require that noise levels be restricted between the hours of 10 p.m. and 8 a.m. This makes it possible for everyone to get a good night's sleep. In addition to paying for their own utilities (if not included as part of the rent) and other costs, tenants must pay the rent on or before the due date. When tenants fail to pay the rent, they can be evicted. **Eviction** is the process of expelling a tenant from the rented property. When this happens, tenants will also be held liable for any property damage and other charges that result from not meeting their contractual duties. If tenants move out voluntarily, they generally must give a 30-day notice. Before signing a lease, you should read it carefully to understand your rights and duties. The agreement will specify what happens when part of the agreement is breached. A contract *breach* occurs when you fail to perform something you agreed to do.

eviction the process of expelling a tenant from rented property

property manager a person hired to take care of rental property and to communicate with tenants on behalf of the owner

LANDLORD RIGHTS AND RESPONSIBILITIES

Landlords or owners have the right to receive their monthly payments for rent in a timely manner. They also have the right to inspect the property, with proper notice, to make sure it is receiving proper care, and not abuse, from the tenant. They can retain security deposits for damages caused by the tenant.

Landlords must provide safe, sanitary, and habitable living sites for tenants. This includes keeping the roof, walls, doors, windows, floors, ceilings, and stairways in good order. Elevators, halls, and stairwells must meet fire and safety regulations. There must be adequate locks and latches, smoke alarms, and fire extinguishers for proper safety and security. Plumbing, lighting, wiring, heating and air conditioning units, and appliances must be in good working order. If some part of the structure is damaged, the landlord is responsible to fix it. The landlord must also provide a convenient way for tenants to pay their rent. In many cases, the owner of an apartment complex will hire an *on-site manager* who lives at the property and has an office where tenants can take their rent payments. An on-site manager will also provide or arrange for routine maintenance and supervise the safety of common areas.

An owner may hire a **property manager**, or *off-site manager,* who is responsible for taking care of the property and communicating with tenants. Property managers will collect rents, hire people to make repairs, and provide an accounting to the owners. The property manager charges a fee for the service of assuming these responsibilities for the owner.

What are the duties of a property manager?

©Christopher Halloran, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

READING A LEASE AGREEMENT

A *lease* is a property rental agreement that lasts a year or longer. With a *month-to-month agreement*, you are free to leave at any time (with a 30-day notice). Many landlords prefer the lease. It gives both the *lessor* (landlord) and the *lessee* (tenant) the security of knowing the property is committed for a fixed period of time. But the lease can also be a trap if you don't read and understand its provisions before you sign.

For example, many lessors offer "specials" to those who sign leases for a year or longer. These specials may include reduced monthly rent, reduced deposits and fees, and other concessions. But in many cases, if you need to terminate the lease before the agreed-upon time, there can be enormous consequences. In a typical "special" lease offer, the lessor states that regular monthly rent is $800 per month. If the lessee signs a one-year lease, the rent is reduced to $750 and the move-in fee is reduced from $500 to $300 (this covers the cleaning and other costs that all tenants must pay). Savings are significant. However, the lease also states that if the lessee terminates the agreement prior to one year, he or she must repay the entire rent reduction and the balance of the reduced fee.

Suppose you are the lessee and you must move out early at the beginning of the eighth month. You would have to pay back seven months' worth of reduced rent ($50 × 7) plus the additional $200 move-in fee, for a total of $550. In addition, you are still obligated to pay the remaining five months rent (at the higher rate), unless the lessor can find another tenant to take your place. This type of "deal" can be very expensive and harmful to your budget.

Before you sign a lease agreement, be sure to read it carefully and understand your commitments. You may be able to negotiate better terms at the beginning—before you sign the contract.

Think Critically

1. Check your newspaper or online classified listings for rental housing in the area. Do you see any lease specials? Describe them.
2. Do you know someone who is leasing property? Ask to see the person's lease agreement. Or, find a sample lease agreement online. What potentially expensive provisions does it contain?

Landlords and their managers (whether on-site or off-site) are also responsible for keeping tenants' security deposits in a separate account and refunding any unused portions. Tenants are allowed normal wear and tear of the premises. Only damages that are beyond those expected from normal day-to-day living should result in the withholding of all or part of the deposit. For example, a pet deposit protects from damage by pets. If the pet causes no damage, the deposit must be returned at the end of the lease.

CHECKPOINT ▸ ▸ ▸

What are tenant responsibilities?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The act of making a plan and carrying it out to ensure an event takes place

_____ 2. A legally binding agreement that specifies the rights and duties of each party

_____ 3. Something of value exchanged for something else of value

_____ 4. An agreement to bear a portion of an obligation

_____ 5. The process of expelling a tenant from rented property

_____ 6. Your daily routine, or the way you choose to live your life

_____ 7. A rental agreement that specifies rights and duties of landlord and tenant

_____ 8. A person with whom you share living space and responsibilities

_____ 9. A refundable amount paid to cover possible damages to property caused by a tenant

a. consideration
b. contract
c. eviction
d. lease
e. living habits
f. logistics
g. property manager
h. roommate
i. security deposit
j. shared responsibility

CHECK YOUR UNDERSTANDING

10. What living habits and areas of compatibility should be discussed before moving in with a roommate?
11. Explain logistics as it relates to the payment of monthly rent by three roommates who are living together.
12. How is a security deposit different from a cleaning fee?
13. What is the purpose of a group budget?
14. What is the purpose of entering into a written agreement (contract) before moving into an apartment?
15. List several provisions that would appear in a written lease agreement.
16. List three responsibilities of tenants.
17. What is a breach of contract?
18. List three responsibilities of landlords.
19. How is an on-site manager different from an off-site manager?
20. What can cause a person to be evicted from rental property?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why should you discuss shared responsibilities with potential roommates before moving in together?
22. Why is it important to consider living habits of a potential roommate? How might this change when there are three or more persons living together?
23. Why is it important to discuss areas of compatibility before entering into living arrangements with other people? Does this also apply to families or just to unrelated persons? Explain your answer.
24. Why is it important to discuss attitudes about money and spending with others before moving in together?
25. Why do people enter into written agreements? In other words, isn't it just as good to have an oral agreement? Why or why not?
26. Why do tenants need to be aware of their rights and responsibilities? (What might happen if a tenant does not understand his or her obligations to other tenants?)
27. Why are landlords responsible for providing a safe and habitable residence for their tenants? Who must pay for damage to property caused by a storm? Why?

EXTEND YOUR LEARNING

28. Assume you have agreed to rent a three-bedroom apartment with two other roommates. You are Roommate #1. The costs of moving in and renting are listed below:

Cost of rental truck	$ 60
Cost of security deposit	300
Pet deposit for Roommate #2	200
Monthly rent	900
Average monthly utilities	99
Household supplies	60
Household groceries	300
Special diet needs for Roommate #3	100

    a. Prepare a group budget as shown in Figure 8-1.1. Since Roommate #3 has special diet needs, she won't share the costs of household groceries.
    b. Assume Roommate #3 moves out. Revise the group budget for the remaining two roommates. Assume you could move to a two-bedroom apartment on the same premises for rent of $650 per month. There are no moving costs, but the security deposit remains at $300 (and you must return Roommate #3's share of the deposit from the first apartment).
    c. List the questions you would ask of both roommates prior to moving in about (1) their living habits and (2) their areas of compatibility.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-2 Long-Term Debt Repayment

GOALS

- Discuss long-term debt options for the purchase of high-priced items.
- Explain the purpose of a debt repayment plan.

KEY TERMS

- down payment, p. 258
- trade-in, p. 258
- preapproved loan, p. 258
- refinancing, p. 259
- market value, p. 259
- mortgage, p. 260
- debt repayment plan, p. 262
- balloon payment, p. 263
- rent-to-own agreement, p. 263
- prepayment penalty, p. 264

What Are Long-Term Debt Options?

Many high-priced items that have an extended life can be financed with long-term debt. *Long-term debt* is a loan that is payable over a period longer than a year. Examples include car loans, mortgages, and loans to purchase a small business. Most forms of long-term debt involve making monthly payments. *Amortization* is the process of dividing up your debt obligation, plus interest, into equal monthly payments over a set period of time.

BUYING A CAR

With an *installment loan*, you will make regular payments for a set period of time. The period of time and the amount of your monthly payment will be based on the loan amount and interest rate charged.

Typically, a *car loan* is set up as an installment loan with monthly payments. The buyer usually makes a **down payment**, which is a cash deposit toward the purchase price. If you have an existing car, you may use it as a **trade-in** by applying its value to the down payment. Other car-buying costs include the title fee, the annual licensing fee, and sales taxes.

down payment cash deposit toward the purchase price

trade-in something of value applied toward the down payment of a new purchase

Based on your monthly income and living expenses, you can determine how much money you can afford to pay each month for the car payment. You should also factor in the costs of insurance, gasoline, and maintenance. Keep in mind that the car will *depreciate*, or go down in value, over time. The down payment and loan structure should be such that the loan principal is paid down faster than the car depreciates. You do not want to have an *upside-down* loan, which means you owe more on the car than it is worth.

Financing Options

Before buying a car, you should consider getting a preapproved loan at a credit union or bank. With a **preapproved loan**, a maximum amount is established and approved in advance. Knowing you have been preapproved for a loan and knowing your loan limit allows you to focus on negotiating the best deal for the car. Most financial institutions offer loans for 36, 48, 60, or 72 months. Although longer terms mean lower payments, they result in more total interest being paid and a greater chance of having an upside-down loan.

preapproved loan a loan for which a maximum amount is established and approved in advance

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

You might also consider new car dealer financing options. On particular models or at particular times during the year, dealers may offer special deals such as manufacturer-sponsored financing. For example, you may be able to get a 0 percent loan. This is a very beneficial loan, but watch out for the fine print in the agreement. The 0 percent may apply for a limited time only and then revert to a high-rate loan.

Another option is leasing a car. A *car lease* allows you to use the car for a set period of time. You make a monthly lease payment but do not own the car. Leasing can be an attractive option because a monthly lease payment is typically less than a monthly car loan payment. This is because the lease payments are designed to cover only the value of the car you use up during the lease period. You may need a down payment, and you will probably be limited in the number of miles you can drive the car annually (often 10,000 to 12,000 per year). At the end of the lease period, you may have the option to buy the car for its expected value at the end of the agreement. As with any rental agreement, you will be responsible for routine maintenance. But if something major happens, such as engine failure, the leasing company usually pays for it (because it is the legal owner).

©Monkey Business Images, 2010/Used under license from Shutterstock.com

Why might you consider leasing rather than buying a car?

Debt Repayment

As you make your monthly car payments (which include both principal and interest), the balance of your loan goes down. The loan is set up so that more interest than principal is paid off in the first payments. As the interest is paid down, you will begin paying off more of the principal. If you can pay off the debt early, you may be able to save interest costs. During the term of the loan, you may find that you can refinance it at a lower rate of interest. **Refinancing** involves paying off the old loan with a new loan that usually has better terms, such as a lower interest rate. For example, at the time you buy a car, the best interest rate may be 8 percent. But within a couple of years, your credit rating may improve and/or the interest rates for car loans may drop. In such cases, it may be worth it to refinance your loan. By moving to a loan with a 5 percent rate, for example, you could save hundreds of dollars in interest costs.

refinancing paying off an old loan by taking out a new loan, usually with better terms

BUYING A HOUSE

At some point, you are likely to find that owning a house is a better way to go than paying rent. There are significant reasons for owning rather than renting. In most cases, with a house, you will own something that is going up in value, or *appreciating*. **Market value** is the highest price that property will bring on the open market. As your house is appreciating, you are also paying down your debt obligation. Thus, you are building equity in your

market value the highest price a property will bring on the open market

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

property and gaining wealth. *Equity* is the difference in the property's value and what you owe on it. As a renter, you do not build equity in the property.

Owning property also gives you tax advantages. On your federal tax return, you can deduct the interest you pay on your house loan. You can also deduct the property taxes you pay. These deductions will lower your total tax liability. As a renter, you do not get these tax deductions.

In addition, most people believe that owning their own house gives them security, independence, and privacy. They can do what they want with the house, and they are able to come and go as they please without worrying about rules in the rental agreement. In some cases, however, there are neighborhood restrictions and homeowners' association rules to follow.

Financing Options

Buying a house generally involves a large down payment. Lenders typically require you to pay 10 to 20 percent of the total purchase price in cash. For example, a house that sells for $200,000 would require a down payment of $20,000 to $40,000. It can take a long time to save up that much money.

A mortgage is used to finance the balance of your purchase.

mortgage a long-term debt agreement used to purchase real estate

A **mortgage** is a long-term debt agreement used to purchase real estate. The property is used as collateral. Banks and mortgage lenders may offer a *conventional loan*, where you make a large down payment and pay the balance in equal monthly payments for up to 30 years (360 payments). An *FHA loan* is a government-sponsored loan that allows for a smaller down payment but requires you to pay a monthly mortgage insurance premium as well as the principal and interest. The FHA (Federal Housing Administration) insures your loan, making it less risky for banks to lend the money. FHA programs are available to first-time homebuyers, veterans, low-income buyers, and others who qualify.

Several mortgage loan calculators are available online. Based upon the loan amount, interest rate, and number of payments, you can calculate what your monthly payment (for principal and interest) will be. Calculating your payment amount will help you determine what you can and cannot afford.

There are additional costs of buying a house, which include title insurance, filing fees, and closing costs. *Closing costs* are expenses you must pay in order to get a loan. They include charges for appraisal fees, credit report fees, loan origination fees, and recording costs. You will also have to pay property taxes and homeowner's insurance each year. The taxes and homeowner's insurance premiums may be included in your monthly payment, or you may pay them directly to the taxing authority and insurance company. Finally, you will have to pay the cost of any maintenance or repairs needed for your house.

Debt Repayment

To qualify for a mortgage loan to buy a house, you will need a good credit rating and a good down payment. With a *fixed-rate mortgage*, you will have a set interest rate for the full term of the loan. Thus, your amortized monthly house payment will not change. With an *adjustable-rate mortgage* (ARM), the interest rate changes in response to the movement of interest rates in the economy. Thus, your monthly payment is likely to change often. For most people, a fixed monthly payment is the better option. If interest rates drop, you can refinance the loan to get a better rate and to save interest costs.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

FORMAL SPEAKING

The purpose of a formal speech is to convey information, to entertain, or to persuade. When preparing a speech, begin with a clear statement of the goals you want to accomplish. These goals will guide you as you prepare the content of the speech.

Use an outline to develop the content. The outline should have three main parts: the introduction, the body, and the conclusion. The introduction briefly explains your topic. The body gives the details or substance of the speech. The conclusion is a summary or request for action.

As you develop the content, consider the audience who will hear the speech. Why will these people be listening? What do they have in common (age, place of work or residence, hobbies, other interests)? How much do they already know about the topic? Answering these questions will help you create content that will accomplish your goals.

Many formal speeches are presented using electronic slides. Projection equipment and software such as *Microsoft PowerPoint®* are often used. The slides help illustrate points and add interest to the speech. Slides should list only the main points being covered. If more detailed information must be shared, use a handout for that material.

A time limit is often set for formal speeches. Practice delivering the speech so you can stay within the required time limit. As you deliver the speech, make eye contact with members of the audience. Use an appropriate tone, rate, and volume. Speaking with confidence and enthusiasm will help keep the audience interested. Pause briefly after important points to allow listeners to think about them.

Effective formal speaking often takes lots of practice and refining of skills over time. After you make a speech, evaluate yourself. Think about what you did well and what you could do better the next time. You may also want to ask the audience to evaluate the speech.

Try It Out

Create a classroom presentation on topics related to car, house, or business loans. Prepare an outline, develop the content, and use PowerPoint slides to guide you through the presentation. Practice your speech so that it will be limited to ten minutes (about ten PowerPoint slides). Evaluate your presentation in terms of your audience's reaction and make suggestions for improvement.

BUYING OR STARTING A BUSINESS

You will also need a large down payment for a *business startup*, which could include buying an existing business or franchise or starting a new business. You will need good credit and a solid business plan. The lender will also want to see financial statements that show projected revenues and expenses. The SBA (Small Business Administration) can provide advice and support for small business owners as well as help in obtaining loans.

You can get various types of business startup loans. A secured loan can be backed with collateral such as the business owner's house or the business's inventory. A line of credit may also be issued to a business so that it has funds readily available as needed. Lenders look more favorably on business owners who have invested some of their own money in the business.

CHECKPOINT

What are the costs of buying a car?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Is a Debt Repayment Plan?

debt repayment plan a strategy for paying off debt in a way that reduces total interest paid

A **debt repayment plan** is a strategy for paying off debt in a way that reduces the total interest paid. With required monthly payments, your debt will be paid off in a fixed number of years. But if you can pay a little extra with each monthly payment, you will bring down your debt much faster. Focus first on the debt with the highest interest rate, since it will provide you the greatest savings with early payoff. Figure 8-2.1 shows how adding just $30 more to a monthly payment will reduce the number of payments and total interest charges. The result is that you will pay off the loan six months early and save $180 in interest charges. To see the savings that result from making additional payment amounts (which all go toward principal) on any loan, you can use a financial calculator or an online debt reduction calculator.

STUDENT LOAN DEBT

Many who attend college can do so only with the aid of student loans. This form of debt is known as a *deferred-payment loan,* because you are able to postpone making payments on it until you have completed your education. Then, hopefully you will begin your career and have steady income that will allow you to make the payments. *Subsidized student loans* are backed by the government and will not accrue interest until you graduate and start making payments. *Unsubsidized student loans* will start accruing interest from the time the loan is taken out. You must reapply for student loans annually, and the terms of these loans, including the interest rate, may change each year.

Following graduation, you will be allowed to *consolidate* your student loans, which means that you can get a new student loan that pays off all the existing student loans. The interest rate on the new loan will be fixed, and your payment will be much lower than the combined payments of the separate loans. However, it will be to your advantage to pay more than the minimum required payment to get the loan paid off quickly.

You might also consider working a year or two in a job where you are providing public service, such as the Job Corps or a job in education. When you have worked in one of these eligible service jobs for a set period of time, half of your student loans can be "forgiven" or discharged. *Loan forgiveness* is a program by the federal government to encourage young people to consider "giving back" to society by performing public service.

Figure 8-2.1 Paying Off Debt Early

Making Required Payments		Making Larger-than-Required Payments	
Amount borrowed	$5,000	Amount borrowed	$5,000
Interest rate	18%	Interest rate	18%
Number of payments	36	Number of payments	30
Monthly payment	$180	Monthly payment	$210
Total interest paid	$1,480	Total interest paid	$1,300

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MORTGAGE DEBT

When incurring mortgage debt, you may have a choice of debt instruments. For example, rather than a 30-year mortgage on a house, you might want to choose a 15-year mortgage. Generally, you can get a lower interest rate (because the term of the loan is shorter), but your fixed monthly payment will be considerably higher. Instead, you could choose the 30-year mortgage and make additional payments toward the principal when possible to reduce the interest charges and the duration of the loan.

Some loans will start with low monthly payments but then have a balloon payment. A **balloon payment** is a large lump-sum payment that must be paid at a set time. The balloon payment is typically the last loan payment. For example, a mortgage may have equal monthly payments of $800 for ten years and a final balloon payment of $5,000. Having this type of loan might be beneficial to some buyers. When interest rates are high, a buyer can get a lower rate, and thus a lower monthly payment, by agreeing to the balloon payment. If the buyer does not want to make the large balloon payment, he or she may refinance the loan before the payment is due. At that time, the buyer may qualify for a fixed-rate mortgage with a more favorable interest rate.

balloon payment a large lump-sum payment that must be paid at a set time

LEASE OR RENT-TO-OWN

Another way of buying is by leasing or renting to own. Under a **rent-to-own agreement**, a portion of the renter's monthly payment is applied toward the purchase price of the rented item. The price is locked in. If the renter elects to buy the property at the end of the lease agreement, he or she has already made a portion or all of the down payment. When people don't have enough money to make a down payment, the rent-to-own option can be a good way of getting the house they want now while at the same time applying money toward its purchase. The purchase option is also known as a *right of first refusal*. In other words, the owner of the property must first give the renter the right to buy the property before it is put on the open market for sale.

rent-to-own agreement a contract in which a portion of the rent payment is applied toward the purchase price of the rented item

Rent-to-own agreements can also be used to buy personal property, such as furniture or electronics. There are advantages to this type of agreement. You would not have to get or use a credit card at the time of purchase. Some lease or rental agreements require that no cash be paid at the time you sign the agreement. You can try the item before you buy it. If you decide you do not want the item, you can return it and end the rental agreement. The contract also provides you with a guaranteed price that will not go up later.

For personal property, the disadvantages of this option often outweigh the advantages. Sellers who provide this option may not have a large selection or choice of models and features available. If you decide not to buy the item, no part of your rent payments is returned to

©XuRa, 2010/Used under license from Shutterstock.com

Why would you use a rent-to-own agreement to buy a house?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 8-2.2 Prepayment Penalty

Terms: $10,000, 5-year loan at 8% with a 60-day interest penalty for early repayment after 1 year

Initial balance	$10,000.00
Monthly payment	202.76
Current loan balance	8,305.60
60-day interest penalty ($8,305.60 × 8% × 60/360)	110.74
Balance to be paid at early repayment	8,416.44

you. The main disadvantage, however, is that after making all the payments, the total price you will have paid for the item is often much higher than if you had purchased the item outright. For example, suppose you rent-to-own a television that sells for $220. You make weekly payments of $10. After making 78 weekly payments, you own the television. You will have paid a total of $780 for an item that sells for $220. This amount compares to paying a loan interest rate of approximately 210 percent. A better option would be to take out a personal or secured loan at a bank to get the money to buy the television. You could also charge the purchase on a credit card. In both cases, the interest rate would be much lower.

PREPAYMENT PENALTY

prepayment penalty a fee charged if you repay a loan before the agreed-upon time

Some types of loans may have penalties for early repayment. A **prepayment penalty** is a fee charged if you repay a loan before the agreed-upon time. For example, suppose you borrow money and agree to repay the loan over a 15-year period. A short time later, you decide to pay off the entire loan balance. The loan agreement may specify a 30- to 90-day interest penalty. The lender has certain costs related to setting up the loan. These costs are spread over the life of the loan. If the loan is repaid early, the lender charges a penalty fee to cover these costs. An example of a 60-day interest penalty on a $10,000 loan that is paid off after one year is shown in Figure 8-2.2.

Repaying a debt early still may be a wise choice, even with a prepayment penalty. If the penalty amount is less than the interest you would pay if you paid on the original schedule, paying off the debt would be to your advantage. Paying debt off early helps your credit score and frees up cash to be used for other purposes (such as savings).

Often, the prepayment penalty is lowered or eliminated after the first few years of the loan. If you want to pay it off early, you may choose to wait until the prepayment penalty period has expired. It's always a good idea to be sure you understand any prepayment penalties before you sign a loan agreement.

CHECKPOINT ▸ ▸ ▸

What is the purpose of a debt repayment plan?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Something of value applied toward the down payment of a new purchase

____ 2. The highest price a property will bring on the open market

____ 3. A fee charged if you repay a loan before the agreed-upon time

____ 4. A loan for which a maximum amount is established and approved in advance

____ 5. A contract allowing a portion of your rent payment to apply toward the purchase price of the rented item

____ 6. A cash deposit toward the purchase price

____ 7. A long-term debt agreement used to purchase real estate

____ 8. Paying off an old loan by taking out a new loan that usually has better terms

____ 9. A large lump-sum payment that must be paid at a set time

a. balloon payment
b. debt repayment plan
c. down payment
d. market value
e. mortgage
f. preapproved loan
g. prepayment penalty
h. refinancing
i. rent-to-own agreement
j. trade-in

CHECK YOUR UNDERSTANDING

10. What is meant by amortization?
11. Why is it a good idea to get a preapproved loan before shopping to buy a car?
12. What are the advantages of leasing rather than buying a car?
13. How can refinancing a loan save you money?
14. What are the advantages of buying a house rather than renting?
15. What are the disadvantages of buying a house rather than renting?
16. How is an FHA loan different from a conventional loan?
17. How is a fixed-rate mortgage different from an adjustable-rate mortgage (ARM)?
18. What is the difference between a subsidized and unsubsidized student loan? What do they have in common?
19. What is the purpose of a prepayment penalty?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. What should you consider when thinking about the early payoff of a loan with a prepayment penalty?
21. Why should you make a substantial down payment when buying a car?
22. If you don't have cash to use as a down payment, you could use your existing car as a trade-in. Explain how this can save you money.
23. Under what circumstances would you want to consider refinancing a debt?
24. Why is it best to have a large down payment (20 percent or more) when you are buying a house and financing the purchase with a 30-mortgage year?
25. Assume you want to open a lawn care business for which you need a startup loan. What kinds of startup costs would you have for this type of business?
26. Why should you pay more than the required amount of a monthly payment as part of your debt repayment plan?
27. If you acquire several student loans through your college years, why is it to your advantage to consolidate those loans upon graduation?
28. Why would you choose a rent-to-own option rather than purchase a house outright?

EXTEND YOUR LEARNING

Point Your Browser

www.cengage.com/school/pfinance/pfl

29. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 8. From the data files, open the Excel file *CH08 Loan Payment Calculator*. Read the instructions provided in the file for using the loan payment calculator. (If you do not have Excel, search for a mortgage calculator on the Internet.) Use it to determine the monthly payments in each of the following scenarios:
    a. Joe Chin bought a house for $180,000. He made a 20 percent down payment. Joe secured a loan for the balance of the purchase price at 6.5 percent interest for 30 years. What will the monthly payments on the loan be?
    b. Louisa Perez bought a house for $300,000. She made a 10 percent down payment. Louisa secured a loan for the balance of the purchase price at 5.95 percent interest for 30 years. What will the monthly payments on the loan be?
    c. Mary Roberts bought a house for $255,000. She made a 5 percent down payment. Mary secured a loan for the balance of the purchase price at 6.75 percent interest for 15 years. What will the monthly payments on the loan be?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-3 Credit Management

GOALS

- List ways to reduce your credit costs and lower your dependence on credit.
- Explain how to avoid credit costs and deceptive credit practices.

KEY TERMS

- billing cycle, p. 267
- unused credit, p. 267
- grace period, p. 268
- annual fee, p. 268
- sales finance company, p. 270
- consumer finance company, p. 270
- loan shark, p. 271
- advance-fee loan, p. 271
- equity stripping, p. 271

How Can You Manage Credit Use?

When you begin using credit, plan to use it wisely. Go slowly; do not use too much credit at first. It is very important to establish credit when you do not need it so that it will be available to you when you do. Build a solid credit history by paying all credit bills on time. Later, when you want to use credit, you will be considered a low (good) risk. You may also be able to borrow at lower interest rates than someone who is considered a high (bad) risk.

Buying items using credit can tie up future income. For example, suppose you buy an item for $500 using a credit card. If you pay the entire amount in one billing cycle, you can avoid interest. The **billing cycle** is the time period (commonly 20 to 25 days) during which you must make your monthly payment. However, suppose you pay the $500 plus interest over six billing cycles. Part of your income for the next six months must be used to pay for the item you purchased this month. You may have to forego buying some other items you want or need during the next six months because the money must be used to pay an existing debt.

billing cycle time period during which you must make your monthly payment

As your earnings go up over time, try to save some of it. Think about future needs rather than only things you presently might want but not need.

You may feel secure in your job and your prospects for the future. However, you should always have a backup plan for handling expenses if you are out of work for a time. Establish a cash fund, and have some unused credit available. **Unused credit** is the difference between your credit limit and your current balance. It is available for immediate use. If you lose your job, you will have money to pay bills until you begin earning money again. You will also have some credit available to make purchases.

unused credit the difference between your credit limit and your current balance

As your pay increases, why should you plan to save most or all of that increased income?

©R. Michael Ballard, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CONSIDER THE ECONOMY

When the economy is doing well and people can get jobs easily, consumers may feel optimistic about the future. This optimism often leads to increased buying. During good economic times, interest rates are usually rising. Thus, rather than buying on credit, this would be a good time to save money and earn interest on those savings.

The opposite is true when the economy is slowing down. People are being laid off, and jobs are scarce. People may feel pessimistic, and this can lead to decreased buying. Because people are buying less, prices may be dropping. This could be a good time to buy because you can get better values. If you do not spend all of your money (and credit) during the good economic times, you will have money available to spend when prices are more favorable.

STUDY CREDIT OFFERS

You most likely will receive credit offers soon after you begin working. These offers are mailed, e-mailed, or found in advertisements. If you want to take advantage of one of these offers, carefully examine each one and compare the *disclosure terms,* which typically include the following:

- *Interest rates.* Are they fixed or variable? How often can they change? What will cause them to change? Fixed rates often do not stay fixed and can be changed with notice from the creditor. However, they are usually better than variable rates, which can rise without advance notice.
- *Grace period.* The **grace period** is the amount of time you have to pay your credit card bill without having to pay interest on your new purchases. Most credit offers allow for a grace period of at least 21 days. The longer the grace period, the more time you have to pay without being charged interest on the purchase amount.
- *Annual fee.* Some credit cards charge an **annual fee** or a "membership fee." This fee is charged regardless of account balance, interest rate, or other features. This fee can be $50 to $100 or more. Once your credit is established, you should be able to avoid cards with annual fees.
- *Minimum finance charge.* Some credit cards require a minimum finance charge of 50 cents or more on unpaid balances in each billing cycle.

grace period the amount of time you have to pay your credit card bill without having to pay interest on your new purchases

annual fee a yearly charge to your account for membership

NETBookmark

How much do you know about credit? Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 8. Take the simple online test to find out how credit-savvy you really are.

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- *Transaction fees*. If you transfer balances from other credit accounts, you may be charged a *transaction fee*. This fee is usually a percentage, such as 3 percent of each transaction, but fees may be as high as $30 or more.
- *Cash advance fees*. Some credit cards allow you to get cash advances at ATM machines and at banks. There is often a fee for this type of transaction. It is usually a percentage, such as 3 percent, with a minimum fee of $5 or more. You should also note that the interest rates on these cash loans are generally higher than on regular credit card purchases.
- *Late fees and over-the-limit fees*. The fee for late payments can be $35 or more. The fee may depend on the balance on your card. The *over-the-limit fee* is usually a flat amount, such as $35 or more. Having late fees or over-the-limit fees can cause the interest rate you are charged to rise. They will also affect your credit score in a negative manner.

Be sure to read all of the fine print in any credit offer before accepting it. Some credit card offers state that the company reserves the right to change the account terms at any time for any reason. This includes raising interest rates on new charges (the interest rate cannot be raised on existing balances). When an interest rate goes up, you must accept the change or cancel the card. Thus, being in a good financial position is important. You want to avoid being in the position of having to accept higher rates and fees because you are ineligible for other types of credit.

MANAGE YOUR DEBT LOAD

A *debt load* is the amount of outstanding debt at a particular time. Whether your debt load is acceptable to you will depend on your ability to make regular payments, your ability to pay off the debt quickly if necessary, and your level of comfort with the amount of debt you owe.

One rule says that installment loan debt should not exceed 20 percent of yearly take-home pay. Another rule holds that you should be able to pay off all installment loan debts in one year at your current monthly payments. Still another says that you should be able to pay off your debts within 30 days if absolutely necessary (with all the cash you can raise).

Debt represents future earnings already spent. Unfortunately, many people never assess how much future income they have already committed to debt and whether the types and sources of credit they use are the most advantageous to them. You can avoid this trap by periodically making a careful assessment of your debt load throughout your life and taking corrective action if necessary.

©Karen Struthers, 2010/Used under license from Shutterstock.com

Why is it important to read a credit offer before you accept it?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHECKPOINT

How should the economy affect your use of credit?

How Can You Reduce and Avoid Credit Costs?

Credit can be costly if the appropriate precautions aren't taken. You need to look for ways to reduce costs and to avoid fraudulent credit practices.

AVOID UNNECESSARY CREDIT COSTS

To avoid credit costs, you may want to pay cash for small purchases instead of using credit. When you do use credit, try to pay the full account balance each billing cycle. If you do, you will not have to pay any interest. Here are several other ways you can reduce your costs:

- *Keep the number of credit cards and accounts you have to a minimum*. Avoid having an account at every store in town and with every bank card available. This eliminates the fees you might pay on multiple cards and helps you avoid overextending your credit. Having a bank credit card such as VISA® or MasterCard® is a good idea because it is accepted at many different businesses.
- *Comparison shop when getting a loan or credit card*. Compare the costs of credit from at least three different sources. When planning a large purchase, such as a car, arrange the financing ahead of time. That way, you will know the dollar amount you can spend and the interest rate you can get. You can then compare it to any finance offers that the seller might have.
- *Consider special deals and financing arranged by the seller*. When buying a car, you may be offered a sales incentive, such as 0 percent interest on a loan or $2,500 cash back on a purchase. These deals are worth considering. In addition to sales incentives, you may be able to get special financing through a sales finance company. A **sales finance company** is a lender that makes loans for the purchase of consumer goods, such as cars or household appliances. The sales finance company often works closely with the seller. This makes it easy for customers to arrange financing at favorable terms. For example, GMAC Financial Services is a sales finance company that offers automobile loans. A **consumer finance company**, on the other hand, generally extends high-interest loans to consumers who may be ineligible for other types of lower-cost loans. These loans are not likely to be beneficial.
- *Use credit to take advantage of sale prices*. With the help of credit, you can buy things on sale that you would not buy if cash were your only option. Thus, you can avoid higher prices and save money.
- *Time your credit purchases*. If you buy right after the closing date of your billing cycle, you may be able to delay payment for two months after the purchase. Most credit accounts have a 20- to 25-day billing cycle.

sales finance company a lender that makes loans for the purchase of consumer goods, often working closely with the seller

consumer finance company a lender that generally extends high-interest loans to consumers who may be ineligible for other types of loans

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

- *Take advantage of cash rebates and rewards*. Many credit cards offer rebate programs. A rebate is a partial refund of the purchase price of an item. For example, a 5 percent rebate would give you back 5 percent of the purchase amounts you made during the month or year. Be careful, however, not to overspend because of the rebates or rewards.
- *Always pay your bills on time or early*. If possible, schedule your payments through your checking account online using *automatic withdrawals*. This ensures that your payment is processed on time and helps you avoid penalties, fines, fees, or increased interest rates due to late or missed payments.

AVOID UNETHICAL LOAN PRACTICES

Some people use unethical loan practices. They take advantage of people who can least afford to pay. Because some people have poor credit ratings or have not used credit wisely in the past, they may not be able to get loans from legal sources. They may decide to take out illegal loans, and the interest may be very high. In states where there are no *usury laws* that limit interest rates, illegal loan practices can flourish.

A loan shark is one source of illegal loans. A **loan shark** is a person who offers illegal unsecured loans at very high interest rates. Unsecured loans are not backed by collateral. Because the borrower is desperate, she or he borrows the money. At such a high rate, however, the debt grows rapidly and is very difficult, if not impossible, to repay. The borrower may receive threats of violence if the loan is not repaid.

loan shark a person who offers illegal unsecured loans at very high interest rates

Many people have lost money in advance-fee loan scams. With an **advance-fee loan**, a lender agrees to make a loan if the borrower pays a large upfront fee. The lender may promise to refund the fee or to apply it to loan payments once the loan has been approved. The fee may be several hundred dollars. Later, the borrower learns that the lender is not reputable. The borrower may be told that the loan has been denied and that the fee will not be refunded as promised. In some cases, the borrower may not hear from the lender again. To make it worse, money may be illegally withdrawn from the borrower's bank account using information provided on the loan application.

advance-fee loans a type of loan that includes a large upfront fee

Equity stripping is the unethical practice of extending a loan to a distressed homeowner who cannot afford the loan payments, resulting in the lender taking possession of the home. A lender points out that the homeowner has equity (value) in the home and can use the home as collateral for the loan. The lender may even encourage the

©Susan Chiang, 2010/Used under license from Shutterstock.com

Why should you beware of offers that sound too good to be true?

equity stripping the unethical practice of extending a loan to a distressed homeowner who cannot afford the loan payments, resulting in the lender taking possession of the home

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

STRESS MANAGEMENT

Stress is a state of mental or physical tension. Many types of changes in life can cause stress. The change can be good, like getting a new job, or bad, like being ill. Stress is not always harmful. Sometimes stress can cause a person to take actions or learn new ways to handle a situation that can be helpful. In other instances, stress can cause problems. Emotional upset, trouble sleeping or concentrating, and even disease can be caused by too much stress.

Everyone experiences stress in daily life. For example, growing credit card debt can often lead to stress. Because too much stress can be harmful, you need to learn to manage factors that cause stress and take steps that will help you cope with stress. The key to stress management is finding things that will work for you. Follow these guidelines to help you control and cope with stress:

- Identify situations that cause negative stress in your life. Take whatever steps you reasonably can to avoid or change these situations. For example, if you are unable to pay your credit card bills, determine what you need to do to improve your situation.
- Seek counseling to help you deal with serious stressful events. If you are having credit problems, credit counselors are available to help you find ways to manage your money.
- Find activities that help you relax, such as a hobby, a sport, or volunteer work. Constantly focusing on your problems will only lead to more stress.
- Spend time with family or friends in relaxing settings. Talking with and getting a family member's or friend's advice can help relieve stress.
- Get enough rest and sleep, eat a healthful diet, and stay physically active. These steps will help you become more physically fit and better able to cope with stress. Deteriorating health due to stress could lead to illness and absences from work, which could result in added stress if you are already experiencing money problems.

Think Critically

1. Using the Internet, locate and read three articles on managing stress. Describe what you learned from the articles.
2. What are some additional tips for managing stress? Which tips do you think would work best for you? Explain why.
3. What have you learned about stress that you can apply to your life?

borrower to overstate her or his income to get the loan. Although the borrower may not have enough income to make the loan payments, the lender approves the loan. Once the borrower starts missing payments, the lender will foreclose and take the home.

These are just a few examples of the ways you can be deceived by unethical or illegal lenders. Whenever you come upon a deal that sounds too good to be true, it probably is. There are always people looking to take advantage of others. Beware of offers for loans with terms that sound unreasonable.

CHECKPOINT

How is a sales finance company different from a consumer finance company?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

8-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A lender that makes loans for the purchase of consumer goods, often working closely with the seller

____ 2. A person who offers illegal unsecured loans at very high interest rates

____ 3. The difference between your credit limit and your current balance

____ 4. A lender that generally extends high-interest loans to consumers who are ineligible for other types of loans

____ 5. The amount of time you have to pay your credit card bill without having to pay interest on your new purchases

a. advance-fee loan
b. annual fee
c. billing cycle
d. consumer finance company
e. equity stripping
f. grace period
g. loan shark
h. sales finance company
i. unused credit

____ 6. The unethical practice of extending a loan to a distressed homeowner who cannot afford the loan payments, resulting in the lender taking possession of the home

____ 7. A type of loan that includes a large upfront fee

____ 8. A yearly charge to your account for membership

CHECK YOUR UNDERSTANDING

9. Explain how using credit ties up future income.
10. Explain why it is important to have unused credit.
11. Why should you consider the economy when planning credit purchases?
12. List the disclosure terms typically included in a credit offer.
13. Why should you be aware of a credit card company's grace period?
14. List three ways you can reduce and avoid costs of credit.
15. How can you use comparison shopping when choosing a credit card?
16. Explain how rebates and rewards help reduce the costs of credit.
17. Describe one unethical and/or illegal loan practice.
18. What is meant by *debt load* and why should it be monitored?
19. Why is it important to be able to cancel a credit card whenever you wish?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is it important to recognize and stay within your billing cycle when making your monthly credit payments?
21. Do you think it is unfair that some consumers get "free credit" by taking advantage of the grace period on credit cards? Explain your answer.
22. Why do interest rates rise during good economic times? What is your best strategy to maximize the benefits of credit while minimizing interest paid on credit?
23. If you plan to pay off your credit card balance each month, should you avoid credit cards with annual fees? Explain your answer.
24. Why is it desirable to keep the number of credit cards you use to a minimum?
25. If you've already received preapproval for a loan through your local bank or credit union for a large purchase, should you consider or avoid a finance offer presented to you by the seller? Explain.
26. When is it advisable to use credit to take advantage of sale prices? When is this not a good practice?
27. To avoid the practice of equity stripping, what advice would you give to a low-income homeowner who needs to borrow money?
28. Why should you comparison shop when seeking to finance a new car purchase?
29. Do you feel that the advantages of using credit outweigh the disadvantages? Why or why not? What advice would you give to a young person who is just starting to use credit?

EXTEND YOUR LEARNING

30. Find three advertisements of offers for loans or credit cards. The loans may be car loans, mortgage loans, student loans, or business startup loans. Newspapers, magazines, bank and credit union lobbies, college admissions offices, and the Internet are places where you may find loan and credit card offers. Find the information below for each loan or credit card offer. Compile this information in a table.
    - Type of loan or credit card
    - Interest rate charged and whether it is fixed or variable (adjustable)
    - Length of the loan in months or years
    - Disclosure terms (grace period/billing cycle, annual fee, minimum finance charge, transaction fees, cash advance fees, late fees, over-the-limit fees, and other penalties and fees)

    Evaluate each offer. Do you think the lender or credit card company is reputable? Are any of the terms questionable? Which loan or credit card offer has the most favorable terms for the borrower?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

LAW ENFORCEMENT

There are many types of police agencies, including state and local police, federal law enforcement, and specialized areas such as campus police. There is also a wide array of law enforcement positions. Police patrol areas, respond to calls from individuals, and investigate suspicious activity. Uniformed officers have general law enforcement duties. Detectives investigate crimes that have been committed, such as homicides and fraud. Federal Bureau of Investigation (FBI) agents are responsible for investigating violations of federal law.

Because of threatening situations, law enforcement work can be dangerous and stressful. Law enforcement agents work 40-hour weeks, but shift work is necessary because protection is needed around the clock.

Employment Outlook

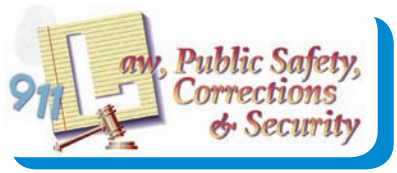
- Employment growth is expected to be faster than average through 2018.

Job Titles

- Police officer
- Police detective
- Sheriff
- Deputy sheriff
- Game warden
- Campus police officer
- FBI agent

Needed Education/Skills

- A high school diploma plus one or two years of college coursework in criminal justice are required.
- Some positions (especially at the state and federal levels) require a bachelor's degree and experience.



What's it like to work in . . . Law Enforcement

Raji is a police detective with the city police department. He investigates crimes involving fraud that occur within the city limits. He spends most of his time assessing and collecting evidence, talking with witnesses, and preparing reports for the district attorney who will decide if there is sufficient evidence to charge a suspect.

Today, Raji is interviewing the victim of a fraudulent scam. He works closely with a partner who is also investigating the crime. He will be doing computer searches as well to try to match evidence and data to previous crimes. Raji will involve the FBI if he discovers that the suspect has committed similar crimes in other states.

Raji is in the office about one-fifth of the time; the rest of his time is spent out in the field gathering evidence to determine what happened and why.

What About You?

Would you find satisfaction in protecting the people of your community? Would you like working with others and preparing reports that lead to the arrest and conviction of criminals? Would a job in law enforcement appeal to you?

©Derek L. Miller, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 8 Assessment

SUMMARY

8-1 Before moving into a shared living arrangement, you should discover each other's living habits and establish a group budget so that each person knows and pays his or her fair share.

A contract is a legally binding agreement that specifies the rights and duties of each party to the agreement. A lease is a contract between a landlord and a tenant. Tenants must pay rent on time and obey the rules expressed in the lease. Landlords must provide safe, sanitary, and habitable living sites.

8-2 Long-term debt is used to finance large purchases such as a car, a house, or a business. Most finance options require a cash down payment and monthly payments spread over several years.

Finance options for cars include a preapproved loan from your bank or credit union, dealer financing, and a car lease.

Financing a home requires a mortgage. Finance options for a mortgage include fixed or adjustable interest rates, conventional loans requiring higher down payments, or FHA loans requiring smaller down payments and mortgage insurance.

A debt repayment plan is a strategy for paying off debt in a way that reduces total interest paid.

Student loans may be subsidized (will not accrue interest until graduation) or unsubsidized (begin accruing interest immediately) with payments deferred until after graduation. Upon graduation, the loans may be consolidated into one loan with one lower monthly payment.

Some debt agreements may include a balloon payment and prepayment penalties, which should be avoided in most cases.

A rent-to-own agreement applies a portion of rent toward a down payment and gives the renter first right of refusal at the end of the lease.

8-3 Good credit management includes building credit history slowly and wisely, avoiding tying up future income with excessive credit purchases, establishing a cash fund and unused credit for emergencies, saving during economic upturns and buying during economic downturns, and studying credit offers for the best terms and conditions.

To reduce and avoid credit costs, keep the number of credit accounts to a minimum, comparison shop, consider special financing arranged by the seller, use credit to take advantage of sale prices, time purchases according to the billing cycle, take advantage of rebate and rewards programs, always pay bills on time, and avoid unethical loan practices.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Determine the required amounts in each of the following independent scenarios:
   a. The following charges are part of the closing costs for a mortgage loan. What is the total amount of the closing costs?

Loan amount (principal)	$250,000
Appraisal fee	$500
Lender's inspection fee	$250
Credit report fee	$50
Loan origination fee	1% of loan amount
Notary public fee	$60
Document recording fees	$75
Title search	$250
Survey fee	$250
Flood certification	$30
Buyer's attorney fees	$750

   b. Albert Morrison took out a loan for $90,000 at 10 percent interest for 15 years. Albert's monthly payments are $967.14. Part of each payment is applied to the loan balance, and part is applied to interest. He has made payments for 2 years (24 payments). He now wants to repay the loan early. The current principal balance owed is $84,257.19. The loan agreement specifies a $468 prepayment penalty. Will Albert save money by repaying the loan (current balance plus penalty) at this time? If so, how much will he save?
   c. Sue Thomson bought a house for $178,750. She is getting a mortgage for $145,000. If a mortgage is for more than 80 percent of the value of the home, Sue's lender requires that the borrower purchase mortgage insurance. Will Sue have to purchase the insurance?
2. **Math** Whether to buy or lease is an important choice. Different forms of credit have different costs. You have decided you need a laptop computer. The purchase price of the computer is $1,200. Compare the following options: (a) paying for the computer using a credit card, (b) renting it to own, and (c) leasing the item. After evaluating the details that follow, indicate which option you would choose and why.
   a. You can buy the computer with your credit card and pay for it over the course of one year. The interest rate is 18.99 percent. Each month for 11 months, you will pay $110. In the last month, you will pay the remainder of the outstanding balance. (For the purposes of this problem, assume there will be no other charges or fees on the credit card bill.) The credit card company uses the adjusted balance method to compute interest. What is the total amount (purchase price plus interest) that you will pay?
   b. You can rent and buy the computer from a rent-to-own company. You will pay fixed monthly rental payments of $200. Initially, you are just renting and can cancel the rental agreement and return the item at any time. If you continue renting for 12 months, you will own the computer (and make no more rental payments). What is the total you will pay for the computer using this option?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

c. You can lease the computer for one year. You will be required to make monthly payments of $125. At the end of the year, you can return the computer to the leasing company, lease it for another year, or lease a newer computer instead. What is the total amount that you will pay for one year's use if you choose this option?

3. **Ethics** Using the Internet, research the usury laws in effect in your state. What is the maximum interest rate lenders may charge? Which state(s) has the highest usury interest rate? Which state(s) has the lowest? Are the laws fair to consumers? Should more be done to restrict interest rates and make laws consistent throughout all states?

4. **Economics** Home values and prices change over time. Prepare a two-page report or give a presentation on how housing prices have changed in your local area over the past ten years. Provide reasons for the changes, including how market values may reflect the state of the local and national economy. Cite two or three sources for the information in your report.

Take Action

GROUP PRESENTATION

Work with two or three classmates to complete this activity. Develop a presentation based on a topic related to using credit, such as one of the following:

- The housing market in your local area or state
- The employment market in your local area or state
- The new and used car markets in your local area or state
- Interest rates in the economy
- Loan scams or deceptive practices
- Comparison of interest rates and other credit terms for different lenders in your area

a. Conduct research on your topic. Use local newspapers, magazines, and the Internet.

b. Create an outline of the main points to include in your presentation. Then write down the details you want to cover. Include how the information you found could or should affect use of credit by consumers in your area.

c. Prepare electronic slides, transparencies, posters, handouts, or other visual aids that you can use during your speech.

d. Assign roles for the presentation. Practice as a group. Review the *Building Communications Skills: Formal Speaking* feature in this chapter to help you prepare and deliver the presentation to your class.

Save your presentation materials in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 9

Credit Problems and Laws

9-1 Resolving Credit Problems

9-2 Bankruptcy Choices

9-3 Consumer Protection Laws

©StockLite, 2010/Used under license from Shutterstock.com

Many people get into trouble with credit. Sometimes, it is because of overspending and not managing credit carefully. Other times, it is because of errors, fraud, and intentional acts by others to steal money and resources. In this chapter, you will learn how to resolve problems with credit and protect yourself from unethical and illegal practices. Avoiding credit problems is not always possible. Sometimes you must resolve disputes and take positive steps to protect your creditworthiness. In extreme situations, the solution may be to file for bankruptcy. There are many laws and agencies that help protect consumer interests in the areas of credit reporting, billing, collections, and the granting or denial of credit. Consumers should know and exercise their rights when confronted with difficult credit issues.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Key Terms Flashcards
Flash Game
Chapter 9 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-1 Resolving Credit Problems

GOALS

- Explain how to dispute errors on billing statements and list ways to prevent credit card fraud.
- Describe the purpose of consumer advocacy groups and government consumer protection agencies.
- Recognize how to avoid collection, garnishment, and foreclosure procedures.

KEY TERMS

- disputing a charge, p. 280
- documentation, p. 280
- dispute letter, p. 281
- credit card fraud, p. 282
- consumer advocacy, p. 282
- loan modification, p. 285
- credit delinquency, p. 285
- garnishment, p. 286
- repossession, p. 286
- foreclosure, p. 286

How Can Consumers Protect against Credit Errors and Fraud?

When buying goods and services, there may be times when you think that you have been cheated or that an error has been made. You may be due some type of adjustment to your account. To get redress (a remedy), you must take action. You may also experience credit card fraud at some point in time. There are actions you can take to avoid becoming a victim.

ST# OP# TE# TR#
005749801035 3.38
007065200750 2.97
007065200750 2.97
006025835503 14.96
068113176369 4.97
002340035457 0.93
005963148202 3.87
002340035458 0.93
005920000731 0.93
SUBTOTAL 35.91
HST 15% 4.88
TOTAL 40.79
DEBIT TEND 40.79
CHANGE DUE 0.00
GST/HST RT

PURCHASE TRANSACTION RECORD
40.79
CHEQUING **********
RRN # :
AUTH #:
00 APPROVED-THANK YOU
TERMINAL ID:

ITEMS SOLD 9
TC#

©Johanna Goodyear, 2010/Used under license from Shutterstock.com

What type of documentation is needed to support your claim that there is an error on your statement?

DISPUTING CHARGES

When you receive a credit account statement, compare the charges to your receipts. If you find a charge on the statement that you did not make or that is for the incorrect amount, take action right away to dispute the charge. **Disputing a charge** is the process of informing a credit company of an error on your bill. Disputing a charge usually begins with a telephone call or a visit in person to report and discuss the problem. Whenever you talk to a person about a dispute, write down the date, the person's name and title, the phone number, and the details discussed. Follow up with a written letter explaining what happened. When you keep receipts, statements, copies of correspondence, and written details of the steps you have taken, you have **documentation**, or records that support your claim, that a bill contains an error or a false charge.

disputing a charge the process of informing a credit company of an error on your bill

documentation records that support your claim

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 9-1.1 Dispute Letter

4550 Bay View Road
Hamburg, NY 14075-4450
April 7, 20—

Credit Company
P.O. Box 87483
Wilmington, DE 19850-7483

Dear Sir or Madam

DISPUTE ON ACCOUNT 2444 2344 2317 3243

Please register this dispute of a charge on my recent credit card statement, which is dated April 2, 20—. The incorrect charge is circled on the enclosed copy of the statement.

I called to report this error today and talked to Melanie Smith in your Customer Service Department. The charge is for $46.42 for the purchase of gasoline in Houston, Texas, on March 20, 20—. I did not make this purchase. I have never been to Texas. I have not loaned my credit card to another person or given permission to anyone to use my account. I have had my card with me at all times, and it is not lost or stolen.

Please remove this incorrect charge from my credit account. If you have any questions about this dispute, please call me at 716-555-0134.

Sincerely,

Joy B. Adams

Joy B. Adams

Enclosure: Credit Statement

Figure 9-1.1 shows a **dispute letter**, which is a letter written to inform a credit company of an incorrect charge on your account. The letter should begin with your return address and the date. Read the credit account information to find the proper address to which you should send a dispute letter. Often, the address is not the same one you use for payments, and the letter should not be mailed with a payment. Include your credit account number in a subject line. State the problem with the account clearly. Give the details needed to make the problem easy to understand. State any earlier steps you have taken related to the problem, such as any phone calls you have made. Indicate that you are enclosing a copy of the statement that contains the error. Continue to communicate with the credit company until the dispute is resolved.

dispute letter a letter written to inform a credit company of an incorrect charge on your account

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

PREVENTING CREDIT CARD FRAUD

You may have improper charges made to your credit accounts. When someone intentionally uses your credit account to steal money or goods, this is a crime called **credit card fraud**. Credit card fraud is a serious crime. If you are a victim of credit card fraud, notify the creditor as soon as possible. Take steps such as the following to help prevent credit card fraud:

credit card fraud intentionally using someone's credit account to steal money or goods

- Carry only the cards you need.
- Keep a list of credit card account numbers and phone numbers to call so that you can rapidly report a card that is lost or stolen. Even though your personal liability is usually limited (to $50 or less), merchants, banks, and credit card companies are also affected. These businesses often pass on the costs of fraud to consumers in the form of higher fees and interest charges.
- Verify purchases and account balances when you receive a statement.
- Shred old receipts and statements containing your account numbers when you no longer need them.
- Do not loan your credit card to others.
- Know where your credit cards are at all times.
- Close inactive accounts because they are often targeted by thieves.
- Have mail delivered to a post office box or a secure mailbox.
- Mail bill payments only from a secure mailbox or a post office.
- Use only secure websites and buy online only from reputable companies you know.
- Do not give out credit card or other private information over the telephone or by e-mail to people who say they are calling from your bank or credit card company.
- Monitor your credit activity online if possible, verifying purchase dates and amounts. Payments can be made electronically, and current activity and balance information can be viewed.

CHECKPOINT

What should you do if you find an error on your credit card statement?

What Help Is Available to Consumers?

Sometimes you may have difficulty resolving a dispute on your own. In such cases, there are consumer advocacy groups and government agencies that can help you.

CONSUMER ADVOCACY GROUPS

consumer advocacy process of helping consumers resolve problems

The process of helping consumers resolve problems with creditors and others is called **consumer advocacy**. Consumer advocacy groups are mostly nonprofit organizations that promote consumer rights. They often provide information about laws related to consumer rights. Many of the groups actively work to get laws passed that will be beneficial

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 9-1.2 Consumer Advocacy Groups

Better Business Bureau	Promotes responsible business practices in the marketplace to build trust between buyers and sellers
Consumer Action	Promotes consumer rights, publishes educational materials, and advocates for consumers in the media and before lawmakers
Consumer Federation of America	Works to advance pro-consumer policies on a variety of issues before state and federal legislatures, regulatory agencies, and the courts
Consumers Union	Provides advice about products and services in its publication *Consumer Reports*
National Consumers League	Sponsors the Fraud Center and addresses a wide range of issues in the marketplace
Public Citizen	Addresses issues such as the consumers' right to seek redress; clean and safe energy sources; and strong health, safety, and environmental laws

to consumers. Some groups focus on a single area, such as food safety. Other groups address a wide range of issues.

Several groups deal with consumer issues related to using credit. You can visit their websites to learn about the latest fraudulent schemes and ways to protect yourself. These websites are a good place to do research before you accept a credit offer that sounds suspicious. Several websites allow users to post complaints about company practices or frauds and read complaints posted by others. Figure 9-1.2 provides a list of several nonprofit consumer advocacy groups.

GOVERNMENT CONSUMER PROTECTION SERVICES

Numerous federal and state agencies assist consumers. These agencies regulate trade, investigate crimes, and enforce laws.

Federal Agencies

There are many federal agencies that protect and help consumers. They provide valuable information and/or assist with the filing of complaints.

The Federal Trade Commission's (FTC) Bureau of Consumer Protection (www.ftc.gov/bcp) seeks to protect consumers against unfair, deceptive, or fraudulent practices through consumer education and assistance with complaints. It publishes tips for avoiding scams and rip-offs and provides a place to file complaints online.

To help consumers find information about consumer-related subjects, the U.S. government provides a website (www.usa.gov). Hundreds of topics can be researched, including identify theft, fraud, scams, recalls, credit reports, and debt abuse.

The *Consumer Action Handbook* contains information about many federal, state, and local consumer agencies. It provides helpful consumer tips about identify theft, understanding credit, filing

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

complaints, and other topics. It is available free of charge to consumers and may be downloaded and printed from the Consumer Action website (www.consumeraction.gov).

The passage of a financial reform bill in 2010 called for the creation of the Consumer Financial Protection Bureau (CFPB). It is designed to assist and protect consumers from abusive practices in the financial services industry, including institutions that provide mortgages, credit cards, and other types of loans.

The Federal Bureau of Investigation (FBI), which is part of the U.S. Department of Justice, investigates fraud and other crimes. It also provides information on issues such as identity theft and current scams and warnings on its website (www.fbi.gov). The FBI is also represented in the Financial Fraud Enforcement Task Force (www.stopfraud.gov), which was established in 2009 to investigate and prosecute significant financial crimes and to recover money lost by victims of these crimes.

State Agencies

State governments also have consumer protection agencies. Consumers can find the latest information about products and crimes, file reports, and ask questions. Many counties and cities provide consumer alerts and support as well. District attorneys' offices and nonprofit groups serve as places to get information. City and county government offices and local offices of consumer groups can be found using the Internet and the telephone book.

CHECKPOINT ▸ ▸ ▸

What is a consumer advocacy group? What does it do?

What Problems Can Arise from Debt?

Every year, millions of consumers get into financial trouble because they have too much debt. Often this happens because of a job loss, illness, or other event that disrupts income and the ability to pay existing credit obligations.

There are many warning signs that debt has become a problem:

- Your credit card balances are at or near your credit limit.
- You are making only minimum payments.
- You may skip some payments in order to make other payments.
- You often pay one credit card by shifting the balance to another credit card.
- Credit card companies are reducing your credit limit.
- Your credit score is falling because you have too much credit.
- You are receiving phone calls from creditors and/or collectors.
- You are unable to save or invest money because of debt obligations.
- You are feeling stressed because your monthly payments are so high that you have little or no money left to meet basic needs.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

If you experience debt problems, there are certain actions you can take to help resolve them. These actions may help you preserve your credit rating and minimize costs:

- *Call each creditor.* As soon as you are having problems paying bills, call each creditor and discuss your situation with them.
- *Negotiate lower payments or other ways to meet your obligations.* Most creditors want to work with you to find a solution. For example, you may be granted a temporary loan modification. A **loan modification** is a new loan arrangement that allows you to make reduced payments, usually on a temporary basis. Lenders will often lower or postpone payments, reduce interest, or make other special arrangements so you can avoid penalties. This will allow you time to get a job, sell assets, and/or find other ways to meet your debt obligations.
- *Follow up with a letter.* Confirm any agreement reached with a written letter or e-mail stating your understanding of the agreement.
- *Meet your new agreement duties.* Make payments according to the new arrangement.
- *Keep your creditors informed of your situation.* If you need more help, ask early. Ignoring a bad situation will only make it worse.

loan modification a new loan arrangement that allows you to make reduced payments, usually on a temporary basis

If debt continues to build and no action is taken to resolve the problem, you may experience several negative consequences.

CREDIT DELINQUENCY

The failure to pay your debts as required by agreement or by law is called **credit delinquency**. A credit contract requires that you make payments on time. When you do not make payments on time, your account is in delinquency. When this happens, your credit rating and credit score will drop dramatically. You will find it difficult to get credit when you need it. It is important to avoid delinquencies.

credit delinquency failure to pay debts as required by agreement or by law

COLLECTION AGENCIES

If payments on your credit account are overdue, your account may be turned over to a collection agency. Collection agencies legally have the right to represent the creditor to collect the amount due. If there is a dispute with your account, collection cannot begin until the dispute is resolved. If you do not pay your debt, the collection agency may file a lawsuit to get a judgment against you. A *judgment* is a ruling of a court of law. The judgment may give the collection agency the legal right to take assets away or to garnish your wages. This is a situation you want to avoid. A judgment will have a bad effect on your credit rating.

With a collection proceeding, you will have to pay interest, collection fees, and certain other costs of the collection agency. This is in addition to the debt amount owed. Collection costs can sometimes exceed the debt amount. For example, a bounced check in the amount of $50 can result in charges in excess of another $100.

What can you do to avoid having your accounts turned over to a collection agency?

©R. Gino Santa Maria, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

GARNISHMENT

garnishment a legal process that allows part of an employee's paycheck to be withheld for payment of a debt

Garnishment is a legal process that allows part of an employee's paycheck to be withheld for payment of a debt. The money is paid directly from the employer to the creditor. Because the creditor has a legal garnishment order, the employer cooperates. Garnishment is one way creditors enforce judgments to receive payment for a debt.

©Amy Smith, 2010/Used under license from Shutterstock.com

What happens during the foreclosure process?

REPOSSESSION AND FORECLOSURE

repossession the act of taking an asset used as collateral and selling it to pay the debt

A loan that has *collateral* pledged for repayment is called a *secured loan*. If the borrower does not make payments as agreed upon for a secured loan, the property used as collateral can be taken away to pay the debt. **Repossession** is the act of taking an asset used as collateral, such as a car, and selling it to pay the debt. Having an item repossessed hurts the borrower's credit rating.

foreclosure the legal process of taking possession of a house (property) when a borrower does not make mortgage payments as agreed

If a homeowner fails to make house payments, he or she may face foreclosure. **Foreclosure** is the legal process of taking possession of a house (property) when a borrower does not make mortgage payments as agreed. The creditor may be able to force a sale of the property. Money from the sale is used to pay the debt. Debtors may lose the money they have paid so far as mortgage payments. The debtor also may have to pay foreclosure costs, which can include attorneys' fees, court costs, interest charges, and other expenses of collection. Foreclosure will negatively affect a debtor's credit rating.

NETBookmark

Vehicles are among the most frequently repossessed assets. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 9. Read the eHow article about the auto repossession process, and then answer: Does a borrower have to be present when a vehicle is repossessed? What happens to the personal belongings left inside a repossessed vehicle? How can a borrower get the repossessed vehicle back?

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

TELEMARKETING FRAUD

Many legitimate companies solicit or contact consumers by telephone. But there are also many con artists who use the phone to commit telemarketing fraud. Most of the time, they are taking advantage of people's insecurity or willingness to believe that it's their lucky day, which is rarely the case.

Older people are often targeted. This is because they are at home, are more likely to have savings, and are often lonely and willing to talk to people. Some people find it difficult to hang up on others or to say no, even when they really don't want the product or service.

To help protect yourself from telemarketing fraud, know the danger signs. It is illegal for telemarketers to ask for an upfront fee. For example, you do not have to pay taxes or fees to win a prize. Any time you are pressured to act immediately, you should be suspicious. If the telemarketer refuses to send you written documentation, then the company is probably not legitimate. Demands for consumers to send information by wire or courier are warning signs. You should never give out account numbers or other personal information by phone or otherwise. Some clever telemarketers ask consumers to verify personal information that is available through online sources. Then they try to get additional information that can be used for fraudulent purposes or sold to other data miners. *Data miners* gather data about people and publish it as well as sell it for both legal and illegal purposes.

When buying something from an unsolicited call, always use a credit card. This way, you can dispute the charge if it turns out to be fraudulent. Paying with cash, debit card, or check leaves you without your money, and you may not be able to get it back.

Consumers should be very cautious when dealing with unknown companies. If they are located in foreign countries (even though they may appear to be in the United States), it will be very difficult, if not impossible, for law enforcement agencies to pursue them.

Using caller ID is a good way to avoid unwanted calls. You can ask telemarketers to remove your name from their call list. You can also put yourself on the National Do Not Call Registry at www.donotcall.gov to stop most of these calls. Telemarketers who continue to call may be reported at www.donotcall.gov, and any other telemarketing violations may be reported at the National Consumers League's Fraud Center website.

Think Critically

1. Why are some consumers easy targets for telemarketing fraud?
2. Do you have a plan for dealing with callers who interrupt your time at home and try to sell you something you do not want? Explain.

The best way to avoid repossession or foreclosure is to be very careful when buying. Know what you can afford and do not take out a loan unless you are reasonably sure you can make the payments. If you find you cannot make payments as agreed, talk to the lender immediately. Work out an alternate arrangement, give back the asset, or find another way to resolve the problem. By giving back the asset, you can at least avoid the added attorneys' fees, court costs, interest charges, and other expenses of repossession and foreclosure.

CHECKPOINT ▸ ▸ ▸

Why should you avoid delinquencies, repossessions, and foreclosures?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. Process of helping consumers resolve problems with creditors and others

_____ 2. Failure to pay debts as required by agreement or by law

_____ 3. Records that support your claim

_____ 4. A new loan arrangement that allows you to make reduced payments, usually on a temporary basis

_____ 5. A letter written to inform the credit card company of an incorrect charge on your account

_____ 6. A legal process that allows part of an employee's paycheck to be withheld for payment of a debt

_____ 7. The process of informing a credit company of an error on your bill

_____ 8. The act of taking the asset used as collateral and selling it to pay the debt

_____ 9. Intentionally using someone's credit account to steal money or goods

a. consumer advocacy
b. credit card fraud
c. credit delinquency
d. dispute letter
e. disputing a charge
f. documentation
g. foreclosure
h. garnishment
i. loan modification
j. repossession

CHECK YOUR UNDERSTANDING

10. Explain how to dispute an error on your credit statement.
11. List what is contained in a dispute letter.
12. List ways you can protect yourself from credit card fraud.
13. How do consumer advocacy groups help protect consumers?
14. List two federal government agencies that help protect consumers.
15. Describe how you can get help from your state government when you suspect consumer fraud.
16. What should you do if you cannot meet your debt obligations?
17. What is a collection agency? Why might your credit account be turned over to a collection agency?
18. If one of your creditors obtains a legal garnishment order against you, what is likely to occur?
19. List ways consumers can protect themselves from telemarketing fraud.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is it important to keep good records, especially sales receipts, when you purchase products and services on credit?
21. Why should the tone of a dispute letter be firm but not angry? If you have been cheated, isn't it to be expected that you will be angry and frustrated?
22. Since you are limited to a $50 charge if your credit card is lost or stolen, why is it important to report the loss or theft right away?
23. Why is it important for consumers to report fraud to consumer advocacy groups and government assistance sources? In most cases, you don't get your money back, so why bother to report it?
24. Why should you try to work out alternate arrangements with creditors? If you can't pay, why not just stop making payments?
25. Why is it a bad idea to have a credit delinquency and to allow it to reach the point of being turned over to a collection agency?
26. What should you do before purchasing products to help you avoid repossession of those assets?
27. Why are elderly people often the target of fraudulent telemarketing schemes?

EXTEND YOUR LEARNING

28. Consumer advocacy groups have many different goals. They provide information to consumers. They may seek to have laws passed that help consumers. They may provide reports on companies or products or a place to file complaints.

    Working in a small group, select a consumer advocacy group from Figure 9-1.2 or another group approved by your teacher. Search the Internet or other sources to find information about this group. You may find a website sponsored by the group or articles written about the group. Write a summary of the information you find. Include the points listed below and other information you think would be helpful for consumers to know about the group. Give a short presentation or prepare a brochure about this group and include the following information:

    - The group's name
    - When the group was founded
    - The main activities or mission of the group
    - Services offered to consumers by the group
    - Publications or websites published by the group
    - Whether the group is a nonprofit or government-sponsored organization

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-2 Bankruptcy Choices

GOALS

- Explain the reasons for and purposes of bankruptcy and list strategies for avoiding bankruptcy.
- Describe the different types of bankruptcy.

KEY TERMS

- bankruptcy, p. 290
- credit counseling, p. 291
- debt consolidation, p. 292
- equity loan, p. 292
- Chapter 7 bankruptcy, p. 292
- discharge, p. 292
- exemption, p. 293
- Chapter 11 bankruptcy, p. 293
- Chapter 13 bankruptcy, p. 294
- bankruptcy fraud, p. 295

When Is Bankruptcy a Good Choice?

bankruptcy a legal procedure to relieve a person of excessive debt

Credit that is used wisely can be a valuable tool in reaching financial goals. When credit is not used wisely, however, the consumer may build debt to the point that it can never be repaid. **Bankruptcy** is a legal procedure to relieve a person of excessive debt. Bankruptcy is granted by a federal court.

A person obtaining bankruptcy may have to surrender assets to be sold to help pay debts. In a *voluntary bankruptcy*, the individual asks the court to declare bankruptcy. Creditors can also petition the court to force a debtor into bankruptcy. This situation is called *involuntary bankruptcy*.

Bankruptcy should be avoided if at all possible, but there are cases where bankruptcy is the only practical choice. For example, if a person has excessive debt as a result of circumstances beyond his or her control, such as a major illness, the best option may be to file for bankruptcy to get relief from that debt.

Some common reasons why debtors cannot pay their bills and seek bankruptcy include the following:

- Excessive medical bills (even with insurance coverage)
- Small business failure (half of all small businesses fail each year)
- Overspending and unwise use of credit
- Losing employment and being overextended
- Having no savings or emergency fund to access when unexpected events (losses) occur

Depending on the type of bankruptcy granted, all debt may be erased, or a plan may be adopted to pay back some of the debt over a set period of time. Generally, bankruptcy should be the last resort. Consumers should select bankruptcy only when all other alternatives have been tried and have failed.

PURPOSES OF BANKRUPTCY

There are two purposes of bankruptcy law. One purpose is to give a debtor a fresh start. A fresh start is needed when bills are so high that they could never be repaid. The second purpose is to ensure fair treatment for creditors. Bankruptcy laws are there to help people in hopeless

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

situations get back on their feet. Bankruptcy was never intended to be used for reckless spending and avoiding responsibility.

AVOIDING BANKRUPTCY

Consumers should try to avoid bankruptcy if possible. Bankruptcy damages a person's credit rating. It stays on the credit record for up to ten years. It prevents the consumer from getting low interest rates on credit accounts or loans. Bankruptcy can make it difficult to obtain credit, buy a home, get life insurance, or sometimes get a job. The consumer may be left with very little property because it is often sold to pay off debts. Thus, it pays to try to find other ways to solve debt problems.

Credit Counseling

Credit counseling is a service to help consumers manage credit and avoid bankruptcy. Credit counseling is available through nonprofit groups and other organizations. Counselors work with debtors to give advice, set up a budget, and arrange a payment plan for debts. They also provide lifestyle counseling to help people avoid credit problems in the future. Sometimes, these counselors are able to negotiate lower interest rates with creditors so that debt can be paid off sooner. Debtors are required to receive credit counseling from a government-approved organization within six months before filing for any bankruptcy relief to ensure that bankruptcy is the best option. You can find an approved credit counseling agency in your area on the U.S. Trustee Program website (www.justice.gov/ust).

credit counseling a service to help consumers manage credit and avoid bankruptcy

Debt Management

A *debt management service* works with you and your creditors to create a workable plan for paying off debt. This service often involves turning over your checking account and your bills to a debt manager. It also requires that you have sufficient income to be able to pay the outstanding debt over an extended period of time. There is usually a fee or a commission charged for this service. You give up your credit cards and live on an allowance. You

©ampyang, 2010/Used under license from Shutterstock.com

How can debt management services help you avoid bankruptcy?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

are also educated in how to prevent credit problems from happening again. At the end of the agreed-upon period of time (usually three to five years), your debt has been repaid, and you get a fresh start.

Some debt management services that claim to be nonprofit charge unreasonably high fees. Many reputable services are accredited through the Association of Independent Consumer Credit Counseling Agencies or the National Foundation for Credit Counseling. Check with these organizations for information about a debt management company.

Debt Consolidation

debt consolidation the process of getting one loan with a single monthly payment to pay off all of your debts

Debt consolidation is the process of getting one loan with a single monthly payment to pay off all of your debts. The single payment is usually much less than the total of the minimum payments on a number of loans or debts.

Consolidation loans are available through banks and other financial institutions. There are finance companies that specialize in loans to pay off credit card debt. Many debt consolidation loans require collateral to secure the loan. If you have equity in your home, your debt consolidation might take the form of an equity loan. An **equity loan** is a second mortgage or debt secured with the equity in your home. For example, if your house is valued at $150,000 and your mortgage is $120,000, then you have equity of $30,000. This amount could be borrowed to pay off high-interest credit cards and accounts. The interest rate is generally much lower, making the payments more affordable. You should know, however, that failure to pay the second mortgage can result in losing your home to foreclosure.

equity loan a second mortgage or debt secured with the equity in your home

CHECKPOINT

When might bankruptcy be your best option?

What Are the Types of Bankruptcy?

There are three common types of bankruptcy: Chapter 7, Chapter 11, and Chapter 13. Chapter 7 bankruptcy and Chapter 13 bankruptcy are for individuals. Chapter 11 bankruptcy is for business owners. With all three forms of bankruptcy, the debtor has an *automatic stay*, which provides immediate protection from any further action by creditors, including collection of debts.

CHAPTER 7 BANKRUPTCY

Chapter 7 bankruptcy the forfeiture of an individual's assets in exchange for the discharge of debts

discharge a court order that pardons the debtor from having to pay debts

Also known as *straight bankruptcy* or *liquidation bankruptcy*, **Chapter 7 bankruptcy** involves the forfeiture of an individual's assets in exchange for the discharge of debts. A **discharge** is a court order that pardons the debtor from having to pay debts. The debtor's assets are sold (liquidated), and the money is used to repay as much of the debt as possible. Then all remaining debts (with a few exceptions) are discharged.

Most debts can be discharged. This includes credit card balances, bank loans, medical bills, and court judgments. There are some types of debt, however, that are not discharged by bankruptcy, such as tax debt,

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

student loans, government fines for criminal charges, child support, and spousal support.

Before filing for Chapter 7 bankruptcy, the debtor has to get credit counseling and satisfy a *means test*. This test requires the debtor to confirm that his or her income does not exceed a certain amount. It prevents people with high incomes from filing for Chapter 7 bankruptcy. The amount varies by state.

Under Chapter 7, debtors may keep some of their property because of certain exemptions. An **exemption** is property that a debtor in bankruptcy does not have to forfeit to pay off creditors. Exemptions typically include assets considered necessary for survival. For example, there is a homestead (housing) exemption that allows the debtor to keep $21,625 worth of equity in a home. If the debtor's equity is that amount or less, the debtor may be able to keep the house if he or she can afford to continue to pay the mortgage.

exemption property that a debtor in bankruptcy does not have to forfeit to pay off creditors

Examples of other federal bankruptcy exemptions are shown in Figure 9-2.1. This is not a complete list, and amounts are adjusted periodically. Many states also have bankruptcy laws that affect the exemptions allowed.

Why does bankruptcy law allow exemptions of some property, such as tools of trade?

CHAPTER 11 BANKRUPTCY

Business owners may choose **Chapter 11 bankruptcy**, which is the reorganization of debt as decided by the court so that a business can remain viable. This type of bankruptcy is also known as *reorganization*. It allows a business to retain possession of its assets and remain in operation after a plan for reorganization is filed and approved by the court.

Chapter 11 bankruptcy reorganization of debt as decided by the court so that a business can remain viable

Figure 9-2.1 Partial List of Exemptions

Federal Bankruptcy Exemptions	
Homestead	$21,625
Household goods ($550 limit per single item)	11,525
Jewelry	1,450
Motor vehicle	3,450
Tools of trade, books, and equipment	2,175
Wild card, $1,450 of any property	1,450

(State exemptions may differ and be more favorable to the debtor.)

©Vladimir Mucibabic, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

PERSUASIVE SPEAKING

When the focus of public speaking is to convince people to take action or to support an idea or position, it is called *persuasive speaking*. To be effective, the speaker must be believable. It is challenging because you may have to change people's minds. You may also have people in the audience who are biased against your ideas or position. Giving public speeches means you are often speaking to people you do not know. You are presenting a message and hoping for their support. For example, people who run for public office must prepare persuasive speeches.

Effective persuasive speeches are relevant, interesting, and decisive. You will need to capture the listeners' attention and hold it as you present information and logical conclusions. When giving a persuasive speech, open with remarks that will get the attention of the audience. Clearly state the position or action you want the listeners to support. Give supporting data or quotes that will strengthen your position. When preparing the speech, think about negative reactions or questions the listeners may have. Prepare answers for these questions.

The next time you hear a campaign speech, listen carefully to what is being said. Also listen to the techniques used in presenting the speech. How did the person get your attention? What problems were discussed? What solutions were proposed? Was the speaker believable? Apply the techniques that you think were effective to your next speech.

Try It Out

Prepare a 10- to 15-minute persuasive speech about a credit practice that you believe is unfair and needs to be changed. List at least one important point you wish to make. It should convince people to do or not to do something. Do research, prepare an outline, and practice your speech. After giving your speech to the class, evaluate your effectiveness. How did the audience react to your speech?

The purpose of Chapter 11 bankruptcy is to make sure that the business can in fact be viable after the bankruptcy proceeding. As a small business owner, you could also elect personal bankruptcy (Chapter 7 or 13), but those forms of bankruptcy do not allow for continuance of the business or the discharge of business debts.

CHAPTER 13 BANKRUPTCY

Chapter 13 bankruptcy a repayment plan for debt for individuals

Also known as *individual debt adjustment*, **Chapter 13 bankruptcy** for individuals involves a repayment plan for some of their debt. It is designed for debtors who have a good source of steady income. It is used mostly by homeowners and working people. Debtors who do not qualify for Chapter 7 bankruptcy may file for Chapter 13 bankruptcy. Rather than liquidate assets, debtors follow a court-approved plan to pay back as much debt as they can over a three- to five-year period. After that time, the remaining balances on debts are discharged if all the payments were made as specified in the plan.

Chapter 13 bankruptcy forces creditors to stop interest and late penalties. While a Chapter 13 plan is in effect, creditors cannot start or continue collection efforts. They must accept what the bankruptcy court decides will be their settlement. In some cases, creditors who have made unsecured loans (loans without collateral) receive no more than 10 to 30 percent of the amount owed to them.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Andresr, 2010/Used under license from Shutterstock.com

When is it unethical to declare bankruptcy?

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005 makes it difficult for consumers to erase all debt by requiring more people to file Chapter 13 bankruptcy instead of Chapter 7 bankruptcy. Sponsored by creditors and credit card companies, the law was designed to crack down on debtors who use bankruptcy laws to run up and then avoid debts.

BANKRUPTCY FRAUD

Bankruptcy fraud is the abuse of bankruptcy laws in a way that favors the debtor and defrauds creditors. Bankruptcy fraud is a serious federal crime. People who do not reveal or who try to hide assets from the bankruptcy court are committing bankruptcy fraud. For example, it is illegal to transfer money or other assets to someone else so that they cannot be located. Assets must be disclosed so that creditors can receive a fair share of the debt repaid.

bankruptcy fraud the abuse of bankruptcy laws in a way that favors the debtor and defrauds creditors

Creating debts with the intent of denying creditors payment for goods and services is also illegal and unethical. Purposely overspending while staying below the allowable exemption amounts is an abuse of bankruptcy laws. If the court suspects that a person is committing bankruptcy fraud, it may dismiss the bankruptcy case and prosecute for fraud.

In the past, bankruptcy fraud has resulted in new bankruptcy laws with tighter restrictions, such as the Bankruptcy Abuse Prevention and Consumer Protection Act. These laws often penalize those who truly need bankruptcy protection, making it harder to get the debt relief they need for a fresh start.

CHECKPOINT

How is Chapter 7 bankruptcy different from Chapter 13 bankruptcy?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. The abuse of bankruptcy laws in a way that favors the debtor and defrauds creditors

_____ 2. The process of getting one loan with a single monthly payment to pay off all of your debts

_____ 3. Property that a debtor in bankruptcy does not have to give up

_____ 4. A legal procedure to relieve a person of excessive debt

_____ 5. A court order that pardons the debtor from having to pay debts

_____ 6. Reorganization of debt as decided by the court so that a business can remain viable

_____ 7. A service to help consumers manage credit and avoid bankruptcy

_____ 8. A second mortgage or debt secured with the equity in your home

_____ 9. Bankruptcy in which an individual's assets are forfeited in exchange for the discharge of debts

a. bankruptcy
b. bankruptcy fraud
c. Chapter 7 bankruptcy
d. Chapter 11 bankruptcy
e. Chapter 13 bankruptcy
f. credit counseling
g. debt consolidation
h. discharge
i. equity loan
j. exemption

CHECK YOUR UNDERSTANDING

10. What are some reasons people get into extreme debt and seek bankruptcy?
11. What are the two purposes of bankruptcy?
12. How is voluntary bankruptcy different from involuntary bankruptcy?
13. Explain how credit counseling can help to avoid bankruptcy.
14. How is debt management different from debt consolidation?
15. What can happen if you are unable to pay back an equity loan?
16. When filing for bankruptcy, what does it mean to receive automatic stay?
17. Why is Chapter 7 bankruptcy also called liquidation?
18. How is Chapter 7 bankruptcy different from Chapter 11 bankruptcy?
19. What is a means test? Explain how it applies to bankruptcy.
20. What is meant by bankruptcy fraud? Give several examples of bankruptcy fraud.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why should some people consider bankruptcy rather than trying to pay off their legal debts? Give examples.
22. Why would a business or other lender want to force another person (debtor) into involuntary bankruptcy? What is the purpose of involuntary bankruptcy?
23. Why do bankruptcy laws require credit counseling before a person can declare bankruptcy?
24. Explain why debt management is the best plan for many consumers who wish to avoid bankruptcy. What do they gain?
25. Why is debt consolidation a good option for consumers with many forms of credit and many credit card payments?
26. What is the major advantage of Chapter 7 bankruptcy? What is the major disadvantage?
27. Why would businesses (large and small) choose Chapter 11 bankruptcy?
28. With Chapter 13 bankruptcy, you pay off a portion of your debts over a three- to five-year time period. Why would you choose Chapter 13 over Chapter 7 bankruptcy?

EXTEND YOUR LEARNING

29. When consumers have serious problems making payments and managing their debt, they may seek advice. Some credit counseling agencies offer free advice; others charge a fee. In some cases, bankruptcy may be the only course available. Consumers may seek legal advice in filing for bankruptcy. Some bankruptcy lawyers will give an initial consultation that is free. During this free session, the client explains her or his situation, and the attorney evaluates the options.
    a. Visit the U.S. Trustee Program website (www.justice.gov/ust) to find a list of approved credit counseling agencies. You can also search the Web using the term *approved credit counseling agencies*.
    b. List the names and addresses of two credit counseling agencies that are approved for residents of your state.
    c. Look in the *Yellow Pages* or search online using the term *bankruptcy attorney*. Review at least two ads or websites for bankruptcy attorneys.
    d. Based on the ads and/or websites you reviewed, what types of claims do attorneys make about bankruptcy? What kinds of fees do they charge? Is there a free initial consultation? What other kinds of information do the ads and/or websites provide about bankruptcy?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-3 Consumer Protection Laws

GOALS

- List and explain consumer protection laws that are related to credit.
- Discuss the processes of using alternative dispute resolution and filing a lawsuit.
- Recognize credit scams and ways to protect yourself.

KEY TERMS

- Fair Credit Reporting Act, p. 298
- credit protection service, p. 299
- Truth-in-Lending Act, p. 299
- Credit Card Act of 2009, p. 300
- Fair Credit Billing Act, p. 300
- Equal Credit Opportunity Act, p. 300
- Fair Debt Collection Practices Act, p. 301
- alternative dispute resolution (ADR), p. 302
- credit repair, p. 304

What Consumer Credit Rights Are Protected by Law?

A number of laws protect consumers from unfair credit practices. These laws also outline consumer responsibilities. Each law is intended to remove some of the problems and confusion surrounding the use of credit.

INVESTIGATE CREDIT DENIALS

Fair Credit Reporting Act a law that grants you the right to know what is in your credit file

If you are denied credit, it may be because there is inaccurate information in your credit file at one of the three major credit bureaus (Equifax, Experian, and TransUnion). The **Fair Credit Reporting Act** grants you the right to know what is in your credit file. You can also find out who has seen your file. You may see your file at no charge within 30 days of a credit denial. You have the right to have inaccurate data investigated, corrected, and deleted from your file, and the credit bureau is required to issue a new report to creditors.

If the damaging information in your file is correct but misleading, you can write your own statement giving your side of the issue. This statement must be added to the file and made available to lenders and others who see your credit report.

REVIEW YOUR CREDIT REPORT

Consumers have the right to one free copy of their credit reports annually. You can learn more about free credit reports on the Federal Trade Commission's website. Consumers should check their credit reports regularly to be sure there are no errors. That way, if an error is discovered, it can be corrected right away before it results in higher interest rates or the denial of credit. Checking the report often can also help protect against credit card fraud.

You can order a credit report online by going directly to the website of one of the three credit bureaus. Or go to AnnualCreditReport.com, which allows you to request a free credit report from each of the three

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Darren Baker, 2010/Used under license from Shutterstock.com

Why should you review your credit report each year?

credit bureaus. You can also request your credit score from the credit bureaus, but you may have to pay a small fee for it.

To get a credit report, you will have to provide personal information, including your social security number. The entire process is relatively quick and easy. If you order your report online, you can have access to it within minutes.

To help keep a watchful eye on your credit file, you may want to enroll in a **credit protection service**, which is a plan that provides credit monitoring for a fee. The service will notify you of any changes to your credit file and let you know when anyone accesses your credit file for any reason. This type of service is offered by credit bureaus, credit card companies, and others. By staying aware of changes to your credit file, you can take steps to correct inaccuracies immediately. Some people consider it to be a good defense against credit fraud and identity theft.

credit protection service a plan that provides credit monitoring for a fee

KNOW THE COST OF CREDIT

The Consumer Credit Protection Act of 1968, better known as the **Truth-in-Lending Act**, requires lenders to fully inform consumers about the cost of credit in a loan or credit agreement. Before the agreement is signed, the following information must be given in writing:

Truth-in-Lending Act a law requiring lenders to fully inform consumers about the cost of credit in a loan or credit agreement

- Description of the item being purchased
- Cash price of the item being purchased
- Down payment or trade-in price
- Amount financed
- Any service fees or other costs being added to the price
- Finance charge
- Annual percentage rate
- Deferred-payment price
- Amounts and dates of payments
- Method of computing finance charge in case of early payoff

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

The Truth-in-Lending Act also limits a person's liability to $50 after a credit card is reported lost or stolen. There is no liability when a card is reported lost before its illegal use. In addition, the law requires that consumers be given a grace period of three days to change their minds about a credit agreement in which their home is used as collateral. During those three days, consumers can change their minds and cancel a credit sale.

KNOW CREDIT CARD PRACTICES

Credit Card Act of 2009 a comprehensive reform to credit card law to establish fair practices related to credit

The **Credit Card Act of 2009** (also known as the Credit Card Accountability, Responsibility, and Disclosure Act) is a comprehensive reform to credit card law to establish fair practices related to credit. It is designed to limit abusive practices by credit card companies. It does the following:

- Protects consumers from arbitrary interest rate increases by giving cardholders advance notice of increases and the right to cancel the card
- Prevents interest from being charged on purchases paid on time during the billing cycle (making double-cycle billing illegal)
- Eliminates due-date gimmicks by requiring card companies to mail bills at least 21 days before the due date
- Requires fair allocation of payments by applying them to higher-interest-rate balances first
- Limits fees card companies can charge
- Requires a minimum payment explanation (showing how long and how much it will cost if only minimum payments are made)
- Limits credit cards issued to teens (under the age of 21) without a cosigner

RESOLVE BILLING ERRORS

Fair Credit Billing Act a law that sets requirements for resolving billing disputes

The **Fair Credit Billing Act** sets requirements for resolving billing disputes. The law applies to open-end credit, such as store or credit card accounts. It does not apply to installment loans. A consumer has 60 days from the day a bill is received to file a dispute. Then the creditor has 30 days to respond to the complaint. Within 90 days after receiving the complaint, the creditor must either correct the error or show why the bill is correct. This law helps consumers resolve errors on their accounts in a timely manner. While an amount is in dispute, the creditor cannot charge interest on that amount. The creditor also cannot try to collect that amount.

All credit card companies must have billing error policies. They must tell their customers how to report errors. Figure 9-3.1 shows an error correction policy for a credit card company.

OBTAIN FREEDOM FROM DISCRIMINATION

Equal Credit Opportunity Act a law that protects consumers from discrimination in the granting or denying of credit

The **Equal Credit Opportunity Act** protects consumers from discrimination in the granting or denying of credit. The act makes it illegal to discriminate on the basis of these factors:

- Gender
- Marital status
- Religion
- National origin
- Race
- Color
- Age

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 9-3.1 Error Correction Policy

In Case of Errors or Inquires About Your Bill

The Fair Credit Billing Act requires prompt resolution of errors. To preserve your rights, follow these steps:

1. Do not write on the bill. On a separate piece of paper, write a description as listed below. A telephone call will not preserve your rights.
   a. Your name and account number
   b. Description of the error and your explanation of why you believe there is an error (Send copies of any receipts or supporting evidence you may have; do not send originals.)
   c. The dollar amount of the suspected error
   d. Other information that might be helpful in resolving the disputed amount
2. Mail your letter as soon as possible. It must reach us within 60 days after you receive your bill.
3. We will acknowledge your letter within 30 days. Within 90 days of receiving your letter, we will correct the error or explain why we believe the bill is correct.
4. You will receive no collection letters or collection action regarding the amount in dispute, nor will it be reported to any credit bureau or collection agency.
5. You are still responsible for all other items on the bill and for the balance less the disputed amount.
6. You will not be charged a finance charge against the disputed amount unless it is determined that there is not an error in the bill. In this event, you will be given the normal 25 days to pay your bill from the date the bill is determined to be correct.

In addition, credit cannot be denied because the person receives government payments, such as unemployment or social security payments. Certain questions cannot be asked, such as which church you attend. The law benefits consumers, because factors other than the consumer's creditworthiness cannot be used when evaluating whether or not to grant credit.

PROTECT AGAINST DEBT COLLECTION PRACTICES

The **Fair Debt Collection Practices Act** protects consumers from abusive collection practices by creditors and collection agencies. For example, threats and intimidation are not allowed. Debtors cannot be called at certain places, such as at work. The time of day is also important. Collection calls may not be made after 9 p.m. Collectors cannot call repeatedly throughout the day. Also, debt collectors must be sure the bill is accurate and allow the consumer to dispute it. Any disputed amounts must be resolved before they can be collected.

Fair Debt Collection Practices Act a law that protects consumers from abusive practices by creditors and collection agencies

CHECKPOINT

Where can you find out more about free credit reports?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Methods Can Be Used to Resolve Credit Disputes?

A consumer may have trouble settling a dispute with a creditor. Rather than give up, the consumer can seek alternative dispute resolution. If that method does not settle the dispute, the consumer might file a lawsuit.

alternative dispute resolution (ADR) a method of settling a dispute using a neutral third party

©Golden Pixels LLC, 2010/Used under license from Shutterstock.com

What are the benefits of alternative dispute resolution?

ALTERNATIVE DISPUTE RESOLUTION

Alternative dispute resolution (ADR) is a method of settling a dispute using a neutral third party. ADR is much less expensive than going to court. It is usually much faster also.

Negotiation occurs when two people get together, with or without a neutral third party, to come to an agreement. Both people express their point of view and how they want to see the issue resolved. They listen to each other, discuss the issue, and come to some type of agreement. The agreement usually involves both sides giving and getting something in return.

Mediation, the next level of resolution, involves using a neutral third party to guide the process. The mediator talks to both parties to hear both sides of the issue. The mediator may allow the parties to talk to each other. The mediator then makes a proposed settlement.

Arbitration is the highest level of resolution. A third party, called an arbitrator, listens to both parties and then makes a decision. The decision may be binding on both sides. Arbitration may take several months. Both sides present their case formally, and rules of law are followed. The arbitrator is a professional who knows the law and is able to understand the issues.

FILING A LAWSUIT

When attempts to resolve a dispute have failed, a consumer may decide to file a lawsuit. Filing a complaint in *small claims court* is a simple and quick method of resolving a matter involving a small amount (usually less than $5,000). The *plaintiff* files a document called a *complaint*, which outlines the issues of the case. The complaint is served on the *defendant*. The two parties appear before a judge, whose decision is final. This process usually takes from a few weeks to a few months. Attorneys do not participate in small claims court.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

DEALING WITH DIFFICULT PEOPLE

At some point in your life, you may find yourself in a situation in which someone is causing problems. Usually the problem is one of attitude. One person does not want to cooperate or go along with your proposal. Instead, she or he wants to be disruptive and difficult.

Strategies for dealing with people in difficult situations start with focusing on the person causing the problem. First, consider who the person is. The person may be someone you do not have to see or deal with beyond the current situation. If this is the case, the best option may be simply to ignore the person's negative comments or bad behavior and continue with your plan. Is the person a customer, a neighbor, or a relative? If so, this should affect how you will approach the situation. You may have no choice but to deal with the person. Try to keep the goodwill of the person and continue to carry out your plan in spite of the person's poor behavior.

Regardless of who the person is, there are some techniques for dealing with difficult people.

- Deal with the issues head-on. This is a good way to keep the problem from getting worse.
- Meet the person in a private setting to discuss the issues.
- Ask the person to explain his or her position or situation.
- Listen to what the person is saying and repeat the concerns.
- Ask for suggestions about how the problem could be resolved.
- Talk to others affected by the behavior. Find out what changes they would like to see.

Bringing the situation to the forefront and dealing with it is often the best way to resolve it. It won't always be a comfortable thing to do, but at least the problem will have been addressed. Using alternative dispute resolution techniques can help resolve certain issues. Unfortunately, difficult situations and people can sometimes lead to lawsuits. In all cases, it's important to know your options for resolving conflict.

Think Critically

Describe a situation where you had to deal with a difficult person. How did you handle it? Did you and the other person feel that it was resolved fairly? What could you have done differently? What will you do the next time a similar situation arises? What did you learn from the experience?

For larger dollar amounts, regular trial courts settle disputes. Attorneys represent each side. The first step is hiring an attorney to represent you. The attorney will try to negotiate a settlement for you. If that fails, a lawsuit is filed. If many consumers have similar complaints about the same defendant, a *class action lawsuit* may be filed on behalf of all of them. When a case goes to trial, the judge or jury will make a decision (called the *verdict*). If you win the lawsuit, you get a judgment against the defendant. This process often takes many months. It may also cost hundreds or thousands of dollars in attorneys' fees.

CHECKPOINT

What are three forms of alternative dispute resolution?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Can You Protect Against Credit Scams?

A *scam* is a fake offer, sale, or other gimmick that will cheat you out of money. Every year, millions of American consumers lose money to scams. The scam may allow thieves to access their bank or credit accounts to steal from them. New credit scams are being developed daily. Ask questions and research offers and companies to avoid being caught in a scam.

CREDIT REPAIR

credit repair a scam in which a company claims to be able to "fix" your poor credit record and give you a clean credit history

Credit repair scams take advantage of consumers who want to improve their credit rating. With **credit repair**, a company claims to be able to "fix" your poor credit record and give you a clean credit history. No one can erase bad credit. The services provided (for a fee) are nothing more than what you can do for yourself. They cannot remove accurate information regarding overdue or unpaid bills from your file. They cannot change your credit score. Any advice they give is already available to you free of charge from various government and nonprofit agencies.

IDENTITY THEFT

Identity theft occurs when someone uses your personal information without your permission to commit fraud or other crimes. According to the U.S. government, identity theft is one of the fastest-growing crimes in America. When a thief has your social security number, he or she can use it to get other personal data. The data may be used to apply for credit in your name to make fraudulent charges. Identity thieves may also use your personal data to open a bank account in your name and then write bad checks against the account. They may open service accounts in your name, such as for telephone or cable TV service, and not pay the bills. They may even take a job and file tax returns using your name and personal data.

Only certain businesses have the right to your social security number, including motor vehicle departments, tax departments, and businesses that report income, such as banks and employers. If you are asked for your social security number by any other person or business, ask why it is needed and what law requires you to give your number.

If you find that your identity has been stolen, or if you lose items that contain your personal data, take the following steps quickly:

1. *Close credit and bank accounts.* Open new accounts with new passwords and credit alerts.
2. *Have a fraud alert placed on your credit reports.* This can help stop someone from opening a credit account in your name.
3. *File a complaint with the Federal Trade Commission (FTC).* Its complaint form is available online. Print a copy and keep it for your records. This record, together with a police report, will entitle you to certain protections, such as ensuring that debts will not reappear on your credit report.
4. *File a report with your local police.* Call the police department and ask to fill out a police report for identify theft. Obtain a copy of the report.
5. *Contact other government agencies.* For example, the agencies that issued your identification documents, such as a driver's license, need to be informed so you can get a replacement document.

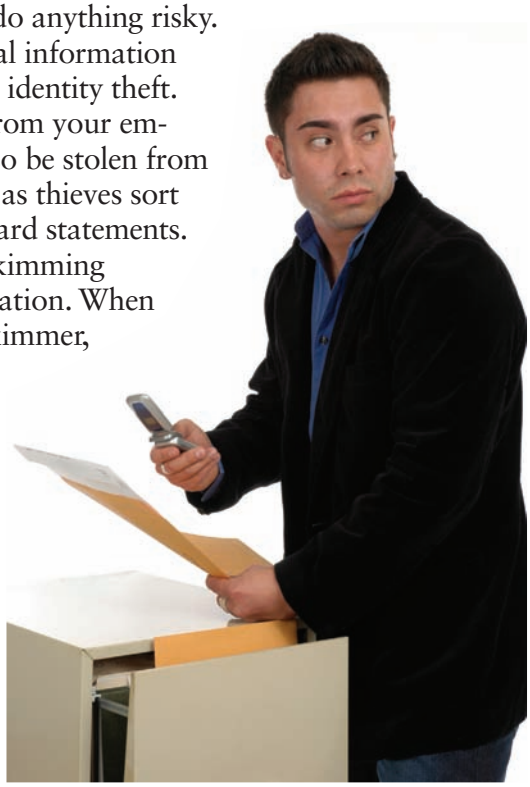
Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Ask the agency to place an alert in your file so that another person cannot get an identification document in your name. You should also file a report with the Social Security Administration to have an alert placed in your file. In a worst-case scenario where someone is using your social security number, you can apply for a new one. You will have to prove (with police reports) that a theft has occurred, and you will also have to provide proof of your income and withholdings to post to your new social security number for tax purposes.

Stealing Your Identity

One reason identity theft is on the rise is because a person's identity can be stolen without any contact with the thief. It can happen even if the victim does not make a purchase or do anything risky. Simple acts, such as giving personal information to an employer, can expose you to identity theft. Your information may be stolen from your employer's records. Your data can also be stolen from your mail or your discarded trash as thieves sort through it to get copies of credit card statements.

Identify thieves can also use skimming devices to steal credit card information. When the credit card is run through a skimmer, the device stores the credit card information. Skimming is more likely to occur at retail stores, restaurants, and gas stations, where cardholders often let their cards leave their sight. It's important to check your credit card statements carefully for fraudulent charges. Also, you should keep an eye on your credit card when you use it.



Why do consumers need to guard against identity theft?

Using the Internet

The Internet has become a popular way to steal personal information. If you use a credit card to make a purchase at an unsecure website, you are putting yourself at risk. *Spam*, which is junk e-mail sent by advertisers, can be part of an identity theft scam. If you respond to spam that makes an appealing offer but requires you to provide credit card information, you may later discover that the promises were not upheld and your credit card was used to make fraudulent charges. Thieves can also steal credit card information by posing as a legitimate business in an e-mail that asks you to confirm and provide personal data. This Internet scam is known as *phishing*.

CHECKPOINT

Why is credit repair considered a scam?

©Mark Stout Photography, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

9-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. A comprehensive reform to credit card law to establish fair practices related to credit

_____ 2. A law that protects consumers from discrimination in the granting or denying of credit

_____ 3. A law that gives you the right to know what is in your credit file

_____ 4. A law that protects consumers from abusive practices by creditors and collection agencies

_____ 5. A law requiring that consumers be fully informed of the cost of credit in a loan or credit agreement

_____ 6. A law that sets requirements for resolving billing disputes

_____ 7. A plan that provides credit monitoring for a fee

_____ 8. A method of settling a dispute using a neutral third party

a. alternative dispute resolution (ADR)
b. Credit Card Act of 2009
c. credit protection service
d. credit repair
e. Equal Credit Opportunity Act
f. Fair Credit Billing Act
g. Fair Credit Reporting Act
h. Fair Debt Collection Practices Act
i. Truth-in-Lending Act

CHECK YOUR UNDERSTANDING

9. How often can you see your credit report free of charge? What website can you use to get a free credit report?
10. List the basic provisions of the Truth-in-Lending Act.
11. Give three provisions of the Credit Card Act of 2009.
12. Explain the procedures for resolving billing errors under the Fair Credit Billing Act.
13. List the items that cannot be used as a basis for determining whether credit should be granted or denied.
14. List debt collection activities that were made illegal under the Fair Debt Collection Practices Act.
15. Explain the process of filing a lawsuit in small claims court.
16. Explain what to do if your identity is stolen.
17. What is spam and how can it be used to steal your identity?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

18. Do you think credit protection services are worthwhile? Why or why not?
19. Would you avoid using a credit repair service? Do you think the costs associated with credit repair services are justified? Explain your answers.
20. Why is identity theft one of the fastest-growing crimes in America? Explain how thieves are able to get personal information from and about consumers.
21. Which of the provisions of the Credit Card Act of 2009 do you think is most important? Explain why.
22. Explain how each method of alternative dispute resolution works (negotiation, mediation, and arbitration).
23. What can you do if you are denied credit? Why should you review your credit report at least once a year? What should you do if you find an error or false information in your credit report?
24. Why is filing a lawsuit considered your last step in settling a dispute with a credit card company? How is an individual lawsuit different from a class action lawsuit?
25. Why is it important for consumers to report scams and identity theft to the appropriate government agency?
26. If you are making a purchase at a store with a credit card and the cashier asks for your social security number, what would you do? Does the cashier have the right to ask for your social security number? Why or why not?

EXTEND YOUR LEARNING

27. Write a few sentences for each situation below, explaining what you would do to resolve it. Be sure to include any outside source of information or support you would seek.
    a. You tried to use your credit card, and it was rejected. When you called your credit card company, you were told that your balance is over the limit. You have not used your card recently, and based on your latest statement information, there should be well over $1,000 worth of credit available on it. What do you do?
    b. A representative from your bank called and told you about a special offer. You will receive a free safe deposit box and a $50 gift if you open a money market account. You verified your personal information with the caller. After the call, you phoned the bank to ask a question about the deal, but you found that no one at your bank knew anything about such an offer. What do you do?
    c. You took your car to have the brakes replaced. When the mechanic did the job, he also found that your muffler needed replacing. You authorized him to do the work. After you got home, you noticed a bill that showed your spouse had the muffler replaced two weeks earlier. What do you do?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

ARCHITECTURE

We all need places to live, work, play, worship, shop, and eat. Architects are responsible for the design of these places, whether they are public or private. Architects are not only concerned with creating structures that are visually appealing but also dedicated to developing safe, energy-efficient, and functional structures.

An architect's duties include selecting the site; preparing feasibility, environmental impact, cost analysis, and land-use studies; specifying design requirements; and preparing detailed drawings. Architects rely heavily on computer-aided design (CAD) systems and building information modeling (BIM) technology. They also help select contractors and negotiate contracts. Architects are involved in building projects from beginning to end.

Employment Outlook

- Employment growth will be faster than average through 2018, increasing by more than 16 percent.

Job Titles

- Architect
- Engineer
- Surveyor
- Commercial designer
- Industrial designer
- Urban planner

Needed Education/Skills

- A five-year bachelor's degree, participation in an internship program, and passage of the Architect Registration Examination (ARE) are required for licensure.

- A post-professional degree is needed for research, teaching, and certain specialty positions.

What's it like to work in . . . Architecture

Bill is an intern for an architectural firm that specializes in designing bridges and skyscrapers. He provides construction designs and support services for many projects. He will work under the direction of well-known and experienced architects until he has enough experience to lead his own projects.

Today, Bill is meeting with clients who are considering the firm for the construction of a new downtown office complex. Bill is part of a team that will prepare the initial design and build a prototype for demonstration to the client.

Bill works in the office most of the time. He also visits building sites to verify dimensions, lighting, and structural and environmental needs.

What About You?

Are you highly skilled in math and computer technology? Do you like to build things and test them for strength and the ability to meet the purpose of their design? Would a job in architecture appeal to you?

©Lorelyn Medina, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 9 Assessment

SUMMARY

9-1 Errors on your credit card statement can be corrected. In addition to a phone call, you must put your dispute in writing and include supporting documentation.

Take precautions to prevent credit card fraud such as carrying only the cards you need, keeping a list of credit card account numbers so you can report lost or stolen cards, verifying purchases on your statement, shredding old receipts containing account information, closing inactive accounts, and monitoring your credit activity online.

Consumer advocacy groups and governmental agencies provide information and help for consumers who are victims of credit-related crimes.

Many problems can arise from debt. Credit delinquencies can result in your account being turned over to a collection agency, your earnings being garnished, and your assets being repossessed or foreclosed (in the case of a house).

9-2 Bankruptcy may be necessary to relieve a person of excessive debt that cannot be repaid. The purposes of bankruptcy are to give a debtor a fresh start and to ensure fair treatment of creditors.

Credit counseling, debt management, and debt consolidation are ways of avoiding bankruptcy.

In Chapter 7 bankruptcy, the debtor gives up property and has most of his or her debts discharged. In Chapter 11 bankruptcy, a business creates a plan for reorganization to emerge as a viable business. In Chapter 13 bankruptcy, debtors follow a plan to pay back as much debt as possible over a three- to five-year period.

Bankruptcy fraud occurs when a debtor abuses bankruptcy laws in a way that defrauds creditors.

9-3 The Fair Credit Reporting Act gives consumers access to their credit file. The Truth-in-Lending Act requires lenders to inform consumers of the costs of credit. The Credit Card Act of 2009 establishes fair practices related to credit. The Fair Credit Billing Act sets requirements for resolving billing disputes. The Equal Credit Opportunity Act protects consumers from discrimination in the granting or denying of credit. The Fair Debt Collection Practices Act protects consumers from abusive collection practices.

Alternative dispute resolution and lawsuits are ways for consumers to resolve credit disputes.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Solve each of the following unrelated credit problems:
   a. Rey Mercado has a house valued at $250,000. His mortgage is for $180,000. How much money can he borrow if the bank will lend 80 percent of the equity in the home?
   b. Jonathon Pratt has a house valued at $180,000. His mortgage is for $150,000. How much money can he borrow if the bank will lend 70 percent of the equity in the home?
   c. Marta Huang has a house valued at $200,000. Her mortgage is for $190,000. How much money can she borrow if the bank will lend 85 percent of the equity in the home?
   d. Your credit card was stolen. You reported the theft within 24 hours. Before the theft was reported, the thief charged $2,450 at a jewelry store and $1,245 at an electronics store. How much of the fraudulent charges will you have to pay?
   e. Jacki Marshall owes a balance of $5,000 on one credit card that charges 19 percent interest. She can pay off the balance in 2 years with monthly payments of $252.04. She has another credit card with a balance of $7,500 that charges 20 percent interest. She can pay off the balance in 2 years with monthly payments of $381.72. Jacki owns a home valued at $150,000. She can get a home equity loan for $12,500 at 8 percent interest. Jacki can repay the loan in 2 years with monthly payments of $565.34. How much money will Jacki save if she takes out a home equity loan to pay off the credit card balances?

2. **Research** Work with two classmates to find out where or how you could file complaints in the situations described below. Review the information presented in this chapter and search the Internet if needed.
   a. You were the victim of a telemarketing scam. The caller offered to send you money if you provided your social security number and bank account number.
   b. You bought items from a business on the Internet. The company did not send the merchandise that was ordered.
   c. An investment scheme promised you a 50 percent return on your money in less than a year. You invested $1,000, and you have not heard from the company since.
3. **Business Law** Due to Marcia's overspending on extravagant items, she has credit card bills and loans that she cannot repay. She decides to file for Chapter 7 bankruptcy to relieve her of all of her debt. Her father recently died and left her a large inheritance including a large sum of money, his house, and many antiques. She plans to transfer all of these assets along with other items she wants to keep to another relative until her bankruptcy is final and then reclaim them afterward. Her overdue accounts were turned over to a collection agency. The collection agent has been calling Marcia three times a day daily, often during work and late in the evening. The agent has threatened to visit her at work if she doesn't pay her bills. What legal issues are evident in this situation?
4. **Economics** The number of home foreclosures rises during poor economic times. Research the impact of foreclosures on communities and our economy. Prepare a one-page report.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

5. **History** Look up the Bankruptcy Act of 1898 online. Write a two-page report covering the following: (a) events that led to the passage of the act, (b) how long the law was in effect, and (c) how it was different from subsequent bankruptcy laws.
6. **International Studies** Conduct online research and prepare a presentation about bankruptcy laws in another country. Compare them to the U.S. bankruptcy laws. Which do you think are more beneficial for consumers? Why?
7. **Research** Use the Internet to find articles about recent fraudulent scams aimed at unsuspecting consumers and businesses. Prepare a PowerPoint presentation or a role-play that describes one of the scams. Conclude the presentation or role-play with a list of tips on how to avoid the scam.
8. **Communication** Conduct online research about data miners in this country—what they do, types of information they gather, and how the information is used. Debate the pros and cons of data mining and its impact on individual privacy in this country. (Your teacher will assign you to the pros or cons side of the debate.)

Take Action

WRITE A LETTER DISPUTING A CHARGE

Upon checking your credit card statement, you see that you were charged $85 for the purchase of a pair of shoes at the Fancy Foot Shoe Outlet on May 8, 20—. You have a receipt that shows a $58 purchase at the Fancy Foot Shoe Outlet on that date. Write a dispute letter to the credit card company to report this error. Be sure to include the information listed below. Review Figure 9-1.1 for the proper format and content of a dispute letter.

a. Use your return address. Use May 12, 20—, as the letter date.

b. Use the following letter address and an appropriate salutation.

   Credit Company
   P.O. Box 87483
   Wilmington, DE 19850-7483

c. Use a subject line that indicates you have a dispute on Account 2444 2344 2317 1111.

d. State that you are registering a dispute. Explain the problem and ask for a credit of the extra amount charged on your statement. Indicate that you are enclosing a copy of the statement and a copy of your receipt.

e. Use an appropriate letter closing and your full name. Add an enclosure notation at the end of the letter.

f. Proofread the letter carefully and correct all errors. Print the letter.

Include a copy of the dispute letter in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER

10 Basics of Saving and Investing

©Stocklite, 2010/ Shutterstock.com

10-1 Reasons for Saving and Investing

10-2 Principles of Saving and Investing

10-3 Strategies for Saving and Investing

Saving and investing can help you accomplish short-term, medium-term, and long-term goals. Some aspects of saving and investing overlap. However, there is a difference between saving and investing. Savings can provide for your short-term needs and goals. Once you start setting aside money on a permanent basis, you will then be in a position where you can make investments, grow wealth, and begin to secure your financial future. Through sustained saving and investing, you will be able to achieve your personal financial goals. Your plan should be based on solid principles of investing. You will want to consider the risk involved and the amount you can expect to earn when evaluating investment choices. Achieving your goals will require that you have sound investment strategies.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Data File
Key Terms Flashcards
Flash Games
Chapter 10 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-1 Reasons for Saving and Investing

GOALS

- Explain how saving and investing are related and how saving leads to investing and wealth.
- Describe how saving and investing help you achieve personal goals.
- Explain how investing prepares you for retirement and beyond.

KEY TERMS

- savings, p. 313
- investing, p. 313
- wealth, p. 313
- emergency fund, p. 313
- liquidity, p. 314
- contingencies, p. 315
- financial security, p. 317
- retirement, p. 318
- estate, p. 319
- foundation, p. 319

How Are Saving and Investing Related?

Money set aside for the future is called **savings**. Another definition of savings is deferred spending. In other words, money not spent today allows for needs to be met in the future. Saving money is important, because it means you are planning for future needs and wants. When you are saving money, the emphasis is on *safety of principal*, which involves protecting the balance in your account. A savings account, a certificate of deposit, and a money market account, which are FDIC insured, are all good, safe ways to save. When savings accumulate above what you might need for short-term goals and emergencies, you have money that can be used for investing.

savings money set aside for the future

Investing money is a good way to plan for future needs. **Investing** is a strategy to earn more on your money than the rate of inflation. Thus, the purpose of investing is to make your money grow. Investing is sometimes explained as using money to make more money. For example, you may use money to buy real estate, such as a house. You might also buy shares of stock in a corporation. Your hope is that the house and stocks will increase in value over the years that you own them. That way, you will have more money when you sell the investments than when you bought them.

investing a strategy to earn more on your money than the rate of inflation

Saving and investing are related, because it is the setting aside of money (savings) that provides the funds that can be used for investing. As investments continue growing, they lead to **wealth**, which is the accumulation of assets over your lifetime.

wealth the accumulation of assets over your lifetime

SAVINGS PROVIDE SECURITY

When you set aside money, you have a reserve or emergency fund that you can count on. An **emergency fund** is an amount of money set aside for unplanned expenses. A fund of $1,000 is enough to cover many types of emergencies. You might keep this sum as the minimum in your checking account. In other words, you would keep your account balance at or above $1,000, just in case you would need it. This way, you wouldn't have to borrow money for an expense such as repairing a transmission. An emergency fund gives you a sense of security—knowing you can take care of emergencies should they arise.

emergency fund money set aside for unplanned expenses

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©Paul Matthew Photography, 2010/Used under license from Shutterstock.com

Why would a savings account not be considered a good long-term investment?

liquidity a measure of how quickly an asset can be turned into cash

Liquidity is a measure of how quickly an asset can be turned into cash. Within your plan for financial security, it is important to have some liquid assets, such as a savings account, that are available to cover unexpected needs.

INVESTMENTS PROVIDE WEALTH

Money left in a savings account or money market account for a long period can be considered a type of investment. However, the interest rate and the money earned on such accounts are typically low compared to other types of investment choices. The primary advantage of these investment choices is safety. Investments with potentially higher rates of return usually carry a greater degree of risk.

Most investments that are considered long-term, strategic choices are designed to stay ahead of inflation. When your investments are growing at a rate faster than the rate of inflation, you are accumulating wealth. When inflation is growing faster than your investments, your wealth is actually diminishing. It is important to make good investment choices that will lead to increased value over the long run.

With some types of investments, such as stocks, you may have temporary setbacks due to market conditions that are beyond your control. You also have the potential for great gain. With many investments, you do not know how much you will earn on the money you invest. You could even lose the money you invest. Typically, your gains will exceed your losses over the 30- or 40-year period you will be investing money.

CHECKPOINT ▸ ▸ ▸

How does saving lead to investing?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Do Saving and Investing Meet Personal Goals?

Saving is a good way to have money to meet short-term, medium-term, and long-term goals. For example, you may want to save money to pay for a trip or to purchase a home theater system. Savings can also be used to handle unexpected expenses, such as repairs to a roof that is damaged by a storm or replacement of a roof after 20 or more years.

MEET SHORT-TERM GOALS

Saving is a *"pay-yourself-first" strategy* that leads to good buying choices. Most of us are more careful about spending money when we have worked hard to save it. Saving for short-term goals will help you reduce your dependence on using credit. When you pay cash for a purchase, you truly feel the value of what you are buying.

You may have short-term goals that saving money can help you accomplish. These goals may involve things you want to get done within the next few weeks, months, or year. For example, you may wish to attend a special event, such as a concert. Other short-term goals may involve contingencies and vacations.

Contingency Planning

Savings allow consumers to meet contingency needs. **Contingencies** are unplanned or possible events. For example, suppose you are driving home from work and a tire blows out. You need money to pay for a new tire, towing, or other related expenses. You need access to cash quickly without borrowing (using credit and paying interest charges). An emergency fund will provide for contingencies.

contingencies unplanned or possible events

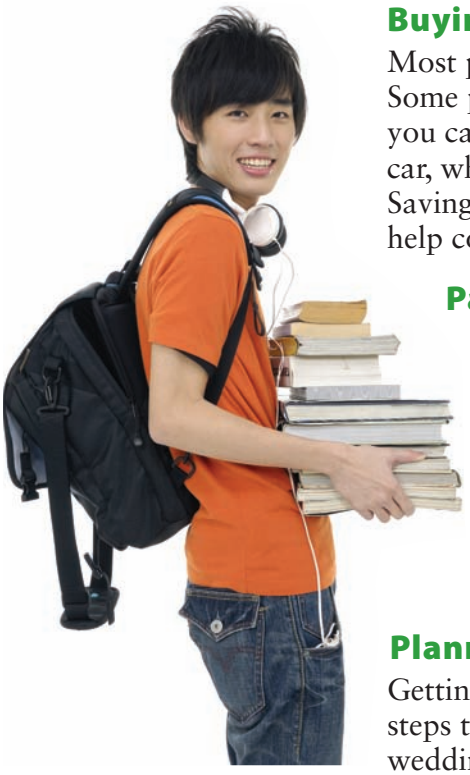
Vacation Planning

Taking a vacation is a healthy thing to do. *Leisure time* is free time used to engage in enjoyable activities. These activities may include playing sports, camping, hiking, raising a garden, and others. Many people need a break from time to time—to get away from the usual stresses in life. A vacation also helps refresh tired minds and bodies so that people are ready to go back to school or work. Vacations can be simple and inexpensive, such as going camping or hiking. They can also be elaborate and expensive, such as flying to Europe for a two-week stay in a resort. Having a savings plan will enable you to cover costs such as deposits and airline tickets so that you can take the vacation you desire.

MEET MEDIUM-TERM GOALS

Goals you want to accomplish in two to five years will require more planning and often will require more savings as well. Examples include buying a car, paying for a college education, or planning a wedding. Accomplishing these goals will require a financial plan that includes saving for down payments and earning income sufficient to make the monthly payments.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.



Why is it important to save for college?

Buying a Car

Most people choose vehicles based on their wants, needs, and values. Some people prefer new cars over used cars. When deciding on a vehicle you can afford, you also need to account for the costs of operating the car, which include insurance, fuel, maintenance, and repair expenses. Saving money for a down payment will reduce the loan amount and help cover other expenses related to car ownership.

Paying for College

A college education can take four to eight years. Costs change over time, including the costs of tuition, books, fees, and on-campus living expenses. Even people who have completed an education and are working find that they need retraining and upgrading of skills throughout their careers. Many students work during the summers and save money to pay for some of their college expenses. Others work full time and go to school part time. It's never too early to start saving for college.

Planning a Wedding

Getting married can be expensive. Wedding planning generally involves steps that take six months to a year or longer. For example, reserving a wedding site can require a year's notice. Weddings are more than 15-minute ceremonies. They often involve elaborate all day or weekend-long activities with family and friends. These events are expensive and require extensive planning. Savings can help cover wedding expenses.

MEET LONG-TERM GOALS

Saving and investing are also required in order to meet long-term goals. For example, if you plan to get married and have children, you will need to think about your goals in five or ten years and beyond. Many people want to own a home. They may save money for a down payment and then buy a house as an investment. All people need to think about retirement and how they will pay for their living expenses when they are no longer working.

NET Bookmark

How much would you have to pay for your "dream wedding"? Make a guess. Then access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 10. Enter the state and number of guests you'd invite and check off all of the options you'd like for your wedding. What figure does the wedding calculator generate for you? How close was your guess? How much would you have to save each month to pay for your dream wedding, presuming that you have five years to save for it?

www.cengage.com/school/pfinance/pfl

©East, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Providing for a Family

Many people plan to have children in the future. These people need to plan for the expenses involved in raising children. Housing, food, clothing, medical care, and childcare are examples of expenses parents must meet for at least 18 years. According to a U.S. Department of Agriculture report, a parent in the United States can expect to spend from $205,960 to $475,680 or more to raise a child from birth through age 17.

Having children will affect daily living expenses, vacations, and even retirement planning. For example, when children are young, parents need life insurance to take care of their children's needs if something happens to the parents. As children get older, plans shift to providing the children with money for education and helping them get started living on their own. Parents of young children can invest money that will grow with the children. Money from certain investments is tax-free if used to pay for college education expenses.

Buying a House

A house can be a good investment that grows in value over several years. Buying a house may require using savings to make a down payment. (Few people can save enough for the full purchase price of their first home.) You may need to save money for a few years to have enough money for the down payment and the closing costs for a home mortgage.

BUILD FINANCIAL SECURITY

Financial security is the ability to meet current and future needs while living comfortably. Financial security should be one of your goals throughout life. For most people, financial security is built on saving and investing. It means having enough resources so that you will have enough to eat, proper clothing, a safe and comfortable place to live, medical care, and other items that you need.

financial security the ability to meet current and future needs while living comfortably

People desire to be financially secure throughout their lives. For most people, however, financial security must be built over time. When you first begin working and living on your own, you may need to spend most of your earnings to cover current expenses. You can save and invest more as your career and income progress. As you save and invest, you can start to build the resources that will provide for your future security.

Being financially secure enables you to meet your personal goals. Once your basic needs are met, you can begin thinking about your short-term, medium-term, and long-term goals. By creating a financial plan that lists goals, benchmarks, and timelines (such as the one you learned about in Chapter 4), you can determine how you will save or invest to meet your goals. By planning ahead, you can help maintain your financial security. A sample financial plan is shown in Figure 10-1.1 on the next page.

CHECKPOINT

What short-term goals and needs are met by savings?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 10-1.1 Personal and Financial Goals

Personal Goal	Financial Goal	Benchmarks	Timeline
Short-Term Goals			
Camping trip next summer	Buy camping gear; buy supplies; pay for transportation	Save $50/month	6 months
Attend concert	Pay for ticket, motel, food, and transportation	Save $75/month	4 months
Medium-Term Goals			
Share wedding expenses	Pay half of expenses for reception hall, flowers, caterer, and photographer	Save $100/month	2 years
Own a car	Put a down payment on a new car	Save $100/month; invest at a safe rate	5 years
Long-Term Goals			
Own a house	Buy a house to meet family needs; need $50,000 down payment	Invest $500/month at growth rate to beat inflation	8 years
Add a swimming pool	Construct inground pool at new home	Invest $150/month at high rate of return	10 years

How Does Investing Prepare You for Retirement and Beyond?

Most people need to plan for the time when they can stop working and start enjoying more leisure time. They will want to be able to live comfortably without worrying about how their bills will be paid. They may also want to take more vacations and see new places. Many people also wish to plan their estates to make sure their finances are in order at the time of their death.

RETIREMENT PLANNING

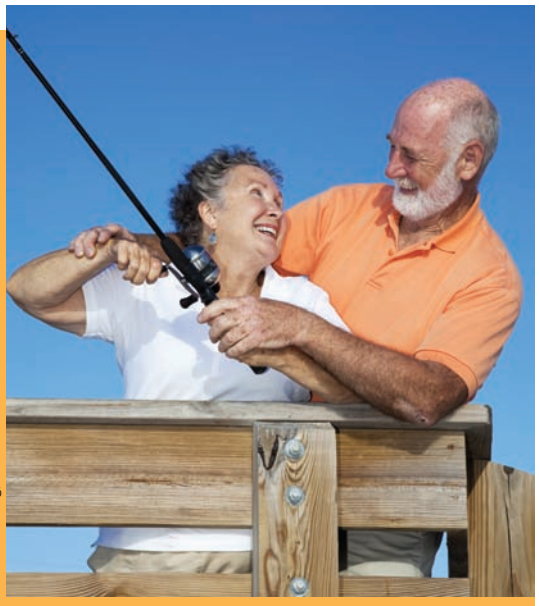
When children become adults and leave home, many people move into a new phase of life. This often involves quitting work, changing to part-time work, moving to a smaller house, or moving to a different location. Investments made during a person's working years can help provide money for activities in later life. **Retirement** is the period of time, usually in later years, when you are not working but are able to meet expenses through other income sources. Sources of retirement income include employer-provided retirement plans, social security, and savings and investments. Some costs, such as those related to working and a mortgage, are eliminated during retirement. Other costs, such as groceries and utilities, tend to stay the same. The costs of medical care and prescriptions tend to increase significantly.

retirement a period of time, usually in later years, when you are not working but are able to meet expenses through other income sources

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

You should begin thinking about retirement even as you begin your first career. Think about what you would like to do and how you would like to live when you retire. Then think about the amount of monthly income you will need to support this lifestyle. Many people, especially the elderly, require long-term medical care at some time during their lives. Retirement plans should include how to pay for long-term care if it is needed.

The sooner you begin investing, the longer your money will have to grow for your retirement. Figure 10-1.2 compares amounts invested at the same rate for varying amounts of time.



©Lisa F.Young, 2010/Used under license from Shutterstock.com

Why are investments an important part of retirement planning?

ESTATE PLANNING

An **estate** is all that a person owns (assets), less debts owed, at the time of that person's death. Assets can include bank accounts, investments, property, and other items of value. Money that is not used for living expenses, travel, and leisure activities will add to one's estate. Life insurance proceeds are also part of the estate. *Estate planning* is the process of preparing a plan for transferring property during one's lifetime and at one's death.

estate all that a person owns (assets), less debts owed, at the time of that person's death

In addition to leaving possessions to heirs, many people designate a portion of their estate for philanthropic causes. They make allowances for donations to their favorite charity, university, and/or church. They may request that money go toward the establishment of a foundation. A **foundation** is

foundation a fund or an organization established and maintained for the purpose of supporting an institution or a cause

Figure 10-1.2 Investment Growth over Time

Amount Invested	Interest Rate	Investment Term	Maturity Value
$10,000 investment	6%	20 years	$32,071
$10,000 investment	6%	30 years	$57,435
$1,000 investment	8%	30 years	$10,063
$1,000 investment	8%	40 years	$21,725
$1,000 per year investment	5%	20 years	$33,066
$1,000 per year investment	5%	30 years	$66,439
$1,000 per year investment	5%	40 years	$120,800
$100 per month investment	7%	25 years	$81,007
$100 per month investment	7%	30 years	$121,997
$100 per month investment	7%	40 years	$262,481

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

HAVING A WILL AND HEALTH CARE DIRECTIVE

Estate planning often involves preparing a will. A *will* is a document that passes title of property after a person dies. For property held in joint names, you do not need a will. But if you have property in your name only, then a will lets you decide where the property goes at your death. If you die without a will, your property will be distributed according to the laws of the state in which you live. This may (or may not) be how you want your property divided at death. Most states require that you reach the age of majority (18 in most states) in order to make a valid will. Minors, or those under age 18, cannot make a valid will unless they are emancipated, which means they are living as adults and no longer being supported by their parents.

A *simple will* is a document that declares you are of sound mind and body and describes your wishes for distribution of your property at death. Provisions of a will include naming your *heirs*, or people who will inherit your money and property. You will also name an *executor*, or person who will be in charge of administering the will along with your attorney. *Probate* is the process of gathering an estate, paying final expenses, and distributing the balance of money and property to those you have chosen. A simple will can cost from a few hundred dollars to a thousand dollars or more. You should contact an attorney for an estimated fee. In many states, a *holographic will* (handwritten) is also valid, or you can purchase a "will kit" online or in office product stores that will meet the probate requirements in your state.

A *trust will* is a long and complicated document with which you leave your estate in trusts to benefit your children and other heirs. It is generally preferred when children are young and a guardian needs to be appointed to care for them and their inheritance. Trust wills typically cost several thousand dollars and must be prepared by attorneys and tax advisers.

In addition to a will, many people also design and sign a *health care directive*. Also called a "living will," this document describes your wishes at the end of life. It specifies the type of effort you would want taken in the event you will not recover from an injury or illness. It's important to appoint someone to make these decisions for you. If there is no such document or person appointed, health care workers will preserve life and will not terminate life support, even if you cannot recover. The health care directive should also state your preferences in the event some of your organs can be recovered and used to help others. Without a health care directive, a person's relatives will be in charge of those decisions, both before and after death.

Think Critically

1. If you were to write a simple will, who would you list as your heirs?
2. What type of health care directive would you prefer to have? Are you or would you like to be an organ donor?
3. What can happen if a person dies without a will and there are numerous potential heirs for that person's estate?

a fund or an organization established and maintained for the purpose of supporting an institution or a cause. Foundations usually seek to help others, achieve a social objective, and/or enrich the community. They support specific activities, such as education, research, veterans' benefits, or cultural literacy.

CHECKPOINT ▸ ▸ ▸

How do living expenses tend to change for retirees?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A measure of how quickly an asset can be turned into cash

____ 2. A fund or an organization established and maintained for the purpose of supporting an institution or a cause

____ 3. The accumulation of assets over your lifetime

____ 4. Unplanned or possible events

____ 5. Money set aside for the future

____ 6. A period of time, usually in later years, when you are not working but meeting expenses through other income sources

____ 7. A strategy to earn more on your money than the rate of inflation

____ 8. The ability to meet current and future needs while living comfortably

____ 9. Money set aside for unplanned expenses

a. contingencies
b. emergency fund
c. estate
d. financial security
e. foundation
f. investing
g. liquidity
h. retirement
i. savings
j. wealth

CHECK YOUR UNDERSTANDING

10. How is investing money different from saving money?
11. Why are savings accounts often safer than other investments?
12. What is the purpose of an emergency fund?
13. List three short-term goals that could be reasons for saving.
14. List three medium-term goals for which most people need savings and investments to achieve.
15. Give two examples of long-term goals that can be met with money from investments.
16. When should you begin retirement planning?
17. What is meant by estate planning?
18. What is the purpose of a foundation?
19. What is the purpose of a will?
20. What is provided with a health care directive?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why is it important to keep your savings safe (take almost no risk) as you begin saving and investing?
22. Why is it important for investments to provide a greater return than the rate of inflation?
23. Why is it important for people to have enough liquidity? In other words, why shouldn't you put all of your savings into a long-term investment?
24. Why is it important to pay yourself first? Give two reasons.
25. What costs might be involved in planning a vacation? Why is it important to plan your vacation?
26. Why should parents devise a plan to help pay for their children's college education?
27. Why do you need to plan for the purchase of a home?
28. Why should you be concerned about retirement planning throughout your life?
29. How can you ensure that your property will be distributed as you intended upon your death?
30. What factors should you consider when planning your estate? Why should you consider charitable donations and possibly setting up a foundation as you plan your estate?
31. If you were to receive an inheritance from someone's estate, what would you do with the money? How might you invest it?
32. What might happen if you don't have a health care directive?

EXTEND YOUR LEARNING

33. People have many purposes for saving and investing. These purposes can be defined in terms of goals, including short-term, medium-term, and long-term goals.
    a. Create a table with four columns similar to the one shown in Figure 10-1.1. The column headings should be as follows:
       Personal Goal **Financial Goal** **Benchmarks** **Timeline**
    b. List at least one short-term goal, one medium-term goal, and two long-term personal goals in the table.
    c. List a financial goal for each personal goal. Include benchmarks (steps to take that allow you to measure your progress) and a timeline for each goal.
    d. Enter the total amount of money you think you will need to meet each goal.
    e. Write a paragraph about your financial plan, explaining what might happen to change your goals over time.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-2 Principles of Saving and Investing

GOALS

- Discuss the concept of risk versus return.
- List and explain the types of risk that are faced by individual investors.
- Describe the tax advantages available with certain types of investments.

KEY TERMS

- return on investment (ROI), p. 324
- investment risk, p. 325
- inflation risk, p. 325
- bond, p. 325
- industry risk, p. 325
- political risk, p. 325
- stock, p. 326
- stock risk, p. 326
- tax deferral, p. 327
- tax-exempt, p. 327

How Is Risk Related to Return?

When selecting an investment, the buyer must weigh the risk involved against the possible return expected. The higher the risk you are willing to take, the greater your possible return will be. If you are not willing to take much risk, then you cannot expect high returns. *Risk-free investments* are those guaranteed by the government, such as U.S. savings bonds and Treasury bills. Savings accounts, money market accounts, and certificates of deposit that are insured by the FDIC are also risk free. As a result, the guaranteed rate of interest is low compared to rates for other investments. Other ways of saving and investing have more risk. As the risk rises, so does the possibility of a high return. The ideal investment would have all of these features:

- The principal is safe (no risk).
- The rate of return (earnings) is high.
- The investment is *liquid* (you can get your money quickly without a penalty).
- You can invest quickly and easily.
- The costs of investing are low, both in terms of the amount invested as well as investment fees.
- The earnings and long-term gains from the investment are tax-free or tax-deferred.

Unfortunately, there are no investments that meet all of these criteria. So you must decide how much risk you are willing to take and what rates of return will meet your goals.

How much risk are you willing to take with your savings?

©DUSAN ZIDAR, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

GROWTH OF PRINCIPAL

When money is set aside for savings, it should be growing. That is, the *principal*, or base amount on which interest is computed, should get larger over time. The principal grows when you deposit more money into the account. The principal also grows through the compounding of interest (as described in Chapter 5). Interest is calculated and added to the principal amount, which becomes the new principal amount. Interest is later calculated based on the new principal amount. This cycle continues, with the interest being added to the previous principal amount each time it is calculated. As the principal increases over time, the value of the investment grows.

RETURN ON INVESTMENT

return on investment (ROI)
a measurement of return expressed as a percentage

When you put money into savings or an investment, you expect the value of the savings or investment to grow. The amount that the savings or investment grows is called the *return*. **Return on investment (ROI)** is a measurement of return expressed as a percentage. ROI tells how much you will receive, either in cash or in increased value. Computing ROI is simple. To find the ROI, divide the amount you gained (either in interest or in increased value) by the amount you invested. The gain could also include other amounts you received, such as dividends. A *dividend* is a portion of a corporation's profits distributed to stockholders.

Figure 10-2.1 shows how ROI is calculated. When you compare the ROI for different investment choices, you can see which has the best return. Based on the return and the risk involved, you would choose an investment option.

CHECKPOINT

What are risk-free investments?

Figure 10-2.1 Return on Investment

Example 1:	Bought an investment for $500; received dividends of $18 for the year. Return: $18 Rate of return: $18 ÷ $500 = 3.6% (annual rate of return)
Example 2:	Bought an investment for $500 on March 1; sold it on October 1 for $525. Return: $25 Rate of return: $25 ÷ $500 = 5% *Note:* The 5% return was received after only 7 months. The annual return would be higher. Calculate the annual ROI as follows: 0.05 ÷ 7 months × 12 months = 8.6% (annual rate of return)

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Types of Risk Do Investors Face?

As an investor, you will face several types of risk. With more risk comes the possibility of higher returns. However, you must be willing to accept the fact that the value of investments is not always rising. In fact, sometimes it is falling.

Investment risk is the potential for change in the value of an investment. Few investments go up in value all of the time. With investment risk, you are looking for investment choices that, on average, go up more than they go down. The goal is to have investments that are worth more at the end of the year than they were worth at the beginning of the year. There are several kinds of investment risk.

investment risk potential for change in the value of an investment

INFLATION RISK

When prices are rising rapidly in the economy, your investment may lose value. **Inflation risk** is the chance that the rate of inflation will be higher than your investment rate of return. When this occurs, your investment loses value.

inflation risk chance that the rate of inflation will be higher than your investment rate of return

For example, assume you bought a bond. A **bond** is a debt instrument that is issued by a corporation or government. Basically, the bond issuer is borrowing from an investor. The issuer must pay the bondholder the principal (the original amount of the loan) plus interest when the bond matures. Suppose the bond has a fixed interest rate of 5 percent. If inflation is lower than 5 percent, your investment is holding its value. If inflation rises to 7 or 8 percent, however, your investment is losing value. You will not be able to purchase as many goods or services with the dollars earned on your investment.

bond a debt instrument issued by a corporation or government

INDUSTRY RISK

Industry risk is the chance that factors affecting an industry as a whole will negatively affect the value of an investment. For example, suppose you invest in a company that is in the oil industry. If oil prices and profits are rising, then your investment is likely to gain in value. If alternate energy sources are found, however, then investments in the oil industry could lose value. People might start buying other types of fuel, and the price of oil could drop. Industry risk occurs in all types of businesses.

industry risk chance that factors affecting an industry as a whole will negatively affect the value of an investment

POLITICAL RISK

Political risk is the chance that a political event (such as a new law or policy, a war, or an election) will affect the value of an investment. For example, when a new president

©Frontpage, 2010/Used under license from Shutterstock.com

How can an election cause your investment risk to change?

political risk chance that a political event will affect the value of an investment

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

is elected in the United States, the stock market sometimes reacts positively, and stock prices go up. One political party may seem to be more pro-business than another. When candidates from this party are elected, stock prices may rise. The opposite may also be true.

Political events in this country, as well as in other countries, affect markets. Wars, terrorist acts, and radical shifts in governments can affect markets significantly. When the news is good, stock prices tend to rise. When the news is bad, prices tend to fall. Political events are out of your control. However, you must consider how political events will affect your investment choices. Some investments are more vulnerable than others.

STOCK RISK

stock ownership interest in a publicly held company

stock risk chance that activities or events affecting a company will change the value of an investment in that company

You can invest in a business by buying your own company. Most people invest by buying **stock**, which is an ownership interest in a publicly held company. **Stock risk** is the chance that activities or events that affect a company will change the value of an investment in that company.

Stock in a company can go up or down in value due to a number of reasons. Poor management or unexpected events, such as product recalls, may affect how well a company performs, which in turn can affect stock prices. If the employees of a company go on strike, fewer products may be produced and sales and income may be lower than expected. This may cause the price of the company's stock to fall. During hard economic times when companies are unable to pay dividends to their stockholders, stock prices tend to fall. During periods when the company does well and pays good dividends, stock prices tend to rise.

Natural disasters may also affect the value of an investment. When a storm, earthquake, hurricane, or flood occurs, it creates damage. The event may destroy crops, buildings, businesses, and lives. A disaster can cause prices to rise or fall. If crops are destroyed, stock prices for companies in that industry may fall. Shortages caused by these events may lead to prices rising in some industries. Other industries benefit because work is created in rebuilding or repairing damage.

Many companies do not perform well all of the time. Companies that show steady growth and strong overall performance over time are usually good investments.

INVESTMENT RISK VERSUS GAMBLING

It should be noted that a *game of chance*, or gambling, is hardly ever a good investment. When you are betting, your chances of winning are much less than 50 percent. Most gambling odds are so low that you will lose nine times out of ten. Even if you do win at times, your overall losses will far exceed your overall gains. A good rule of thumb is, "When you can't afford to lose, then you can't afford to play." Games of chance should be considered entertainment only—not ways to make money. If you set aside a certain sum to gamble, then you can manage your risk.

CHECKPOINT ▸ ▸ ▸

Name various types of investment risk.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

GOOD NEWS MESSAGES

A *good news message* is one that the reader will find favorable or be happy to receive. Good news messages are often written to inform people that their requests have been granted. Thus, the reader is looking for the answer and is expected to respond favorably. The writer can use this opportunity to build goodwill with the reader. The reader will be feeling positive about the main message of the letter.

When writing a message that is good news, use a direct approach. The answer or main point of the message should be placed early in the message. Details should be presented in later paragraphs. For example, the opening of a good news letter might be, "Congratulations, Mr. Mendez. You have been selected to receive a $5,000 scholarship."

A good news message should be clear, leaving no doubt about the answer or point to be shared. The letter should be complete, giving all the details needed. The letter should also be concise. It should use enough words to sound friendly and courteous but not be too wordy.

Try It Out

You work at a bank. The bank is making special offers to its best customers. Customers who qualify can receive higher interest rates on savings and have free access to various bank services. Write a letter to a customer to give her the "good news." Explain that you look forward to serving the customer's needs in the future.

What Are Tax Advantages of Investing?

Investors may realize some important tax advantages for setting aside money over the long term. They include tax deferral, tax exemption, and employer-sponsored contributions.

TAX DEFERRAL

When you set aside money for retirement using certain investment options, such as an IRA (individual retirement account), the money may be tax-deferred. **Tax deferral** is a postponement of taxes to be paid. There are no taxes on gains until the money is withdrawn from the account. Also, you may not have to pay taxes on the amounts you contributed to the account until later. This tax advantage allows your investment to grow for years without being taxed. When you retire and take money from the account, you may be in a lower tax bracket.

tax deferral a postponement of taxes to be paid

TAX EXEMPTION

Some saving and investment choices are **tax-exempt**, which means they are not subject to taxation. For example, interest earned on Series EE and Series I savings bonds is tax-free if they are used for education. Interest earned on municipal bonds (bonds issued by local cities and counties) may be free from federal income tax. Currently, those under the age of 18 can earn up to $1,900 of investment income tax-free. Tax-free choices protect your gains and earnings.

tax-exempt not subject to taxation

People with higher incomes may choose tax-deferred or tax-exempt investments because their tax rates are high. Suppose a person is in a 35 percent tax bracket. If $1,000 is earned on an investment, $350 is paid in tax. If, however, this person invests in a tax-exempt bond and earns $1,000

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 10-2.2 Investment Comparison Based on Tax Rates

INVESTMENT COMPARISON	
Taxable	**Tax-Free**
Corporate Bond at 7% Interest	Government Bond at 5% Interest
The investor pays federal tax at a rate of 35%. The investor keeps 65% (100% − 35%) of the interst earned. The rest (35%) is paid in tax.	The investor keeps all the interest earned at 5%.
$0.07 \times 0.65 = 0.0455 = 4.55\%$ earnings after taxes	

in interest, there is no tax. Interest rates paid on tax-free investments are often lower than market rates, but the tax-free investment may be the better choice, as shown in Figure 10-2.2.

EMPLOYER-SPONSORED PLANS

An employer-sponsored company retirement plan involves money set aside on behalf of employees. It is generally a part of the employee's compensation package. It provides significant tax advantages for employees. Money is not taxed until the employee actually receives it (at retirement).

Most employer-sponsored plans today require that employees pay money into their own retirement funds. Then the employer may do a "match." For example, you may get a 10 percent match—for every hundred dollars you put into your account, the employer adds $10. This is an automatic 10 percent return on your money. The employer-matched funds are added to your account balance so that it will grow faster over time. Any time you are able to get a *money match*, you should set aside as much money as you possibly can. This will maximize your return and lead to accumulation of wealth.

Employees always have the right to claim their own contributions to these plans, but they must be *vested*, or have ownership rights, to claim employer contributions. Employees can become vested after a relatively short period of time, typically after three to five years of employment with the same employer. After that time, if you leave the employer, you can get a cash payout or request a rollover to your IRA account. If you roll the money into your IRA account, you can continue to defer taxes on the money or its earnings until you retire and withdraw the cash. There could be a penalty fee for receiving a cash payout.

Increasingly fewer employers today are offering employer-sponsored plans with a money match. They are instead allowing employees to set aside money in other types of tax-deferred plans, which will be covered in Chapter 11.

CHECKPOINT ▸ ▸ ▸

How is tax-exempt different from tax-deferred?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Chance that a political event will affect the value of an investment

____ 2. Potential for change in the value of your investment

____ 3. A postponement of taxes to be paid

____ 4. A measurement of return expressed as a percentage

____ 5. Chance that factors affecting an industry as a whole will negatively affect an investment

____ 6. Ownership interest in a publicly held company

____ 7. A debt instrument issued by a corporation or government

____ 8. Not subject to taxation

____ 9. Chance that the rate of inflation will be higher than your investment rate of return

a. bond
b. industry risk
c. inflation risk
d. investment risk
e. political risk
f. return on investment (ROI)
g. stock
h. stock risk
i. tax deferral
j. tax-exempt

CHECK YOUR UNDERSTANDING

10. Explain how risk and return are related to each other.
11. Describe the ideal investment.
12. What are the advantages of tax-deferred and tax-exempt investments?
13. How does compounding of interest lead to the growth of principal?
14. Explain how a bond is both a debt instrument and an investment.
15. Name some events that might affect political risk.
16. What might happen at a company that would lead to stock risk?
17. Why are games of chance not a good investment?
18. Under what circumstances can an investment with 5 percent interest bring you higher returns than an investment with 7 percent interest?
19. Why are employer-sponsored retirement plans a good investment for employees?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is it important to consider risk when making investment choices?
21. Why is the return on investment (ROI) an important tool for evaluating your investments?
22. Why do natural disasters sometimes lead to falling stock prices?
23. Explain how a fixed-rate investment can lose value when the rate of inflation is higher than the fixed rate.
24. There is an e-coli breakout on a cruise ship which leads to the cancellation of reservations on other cruise ships. What kind of risk is this to the owners of cruise ships? Why does this happen?
25. Why are political risks difficult to measure and predict?
26. Why is it important for some investors to choose tax-deferred or tax-exempt investments?

EXTEND YOUR LEARNING

27. The criteria for an ideal investment are as follows:
    - The principal is safe (no risk).
    - The rate of return is high.
    - The investment is liquid.
    - You can invest quickly and easily.
    - The costs of investing are low, both in terms of the amount invested as well as investment fees.
    - The earnings and long-term gains from the investment are tax-free or tax-deferred.

    For each situation below, tell which two criteria you think would be the most important for choosing a savings plan or an investment.

    a. Joshua plans to create an emergency fund to pay for unexpected expenses.

    b. Maria wants to see her money grow over several years. She has a separate fund for emergencies that is in a liquid, no-risk account.

    c. Chin wants to save money for retirement. He has a separate fund for emergencies that is in a liquid, no-risk account. He has other investments to help achieve other long-term goals.

    d. Ellen wants to save money to pay for the future college education of her now three-year-old daughter.

28. You are in the 28 percent tax bracket and are considering investing $10,000. Option A pays 8 percent interest and is taxable. Option B pays 6 percent interest and is tax-free. If you earn interest of $750 on Option A and $600 on Option B, how much must be paid in taxes for each option? How much will you keep after taxes? Assuming the risk for both investments is the same, which is the better investment choice?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-3 Strategies for Saving and Investing

GOALS

- Explain the concept of systematic saving and investing.
- Describe how you can lower investment risk through diversifying and building an investment portfolio.
- Explain how you can maximize investment return by understanding the financial marketplace and the economy.

KEY TERMS

- systematic saving, p. 331
- systematic investing, p. 331
- investment tracking, p. 332
- market timing, p. 333
- dollar-cost averaging, p. 333
- diversification, p. 333
- investment portfolio, p. 333
- financial market, p. 335
- bull market, p. 335
- bear market, p. 336

What Are Systematic Saving and Investing Strategies?

Systematic means regular, orderly, or done according to a plan. **Systematic saving** is a strategy that involves regularly setting aside cash that can be used to achieve goals. Once money is set aside in savings, it should remain there until used to meet a planned goal. The amount should be the most you can comfortably afford to save each pay period. Some people find it convenient to have a set amount withheld automatically each month from their paychecks. Others make a monthly payment to a savings plan, just like paying a bill. Some people set aside a portion of any raise they receive at work. Once you have excess savings beyond what you need for emergencies or short-term goals, you can begin investing.

systematic saving a strategy that involves regularly setting aside cash that can be used to achieve goals

Systematic investing is a strategy that involves a planned approach to making investments on a regular basis. When you first start investing, you may wish to buy safe and liquid investments. In later years, you may want to take more risk so your principal can grow faster over time. When you get extra cash, such as a bonus, you might wish to buy a high-risk investment in the hope of getting high returns. Systematic saving and investing are important for building financial security in the long term.

systematic investing a strategy that involves a planned approach to making investments on a regular basis

©Feng Yu, 2010/Used under license from Shutterstock.com

How can a systematic investing strategy help build financial security?

LONG-TERM FOCUS

A systematic saving and investing plan is designed for growth in the long run, not for short-term results. Investors may need to hold investments for 20 or more years to get the

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

returns they want. In any given year, investments may actually lose money. Over time, however, gains exceed losses on sound investments. For example, suppose investments in the stock market have grown at an annual rate of more than 7 percent over any 20-year period of time. This does not mean that, in any given year, stocks earned 7 percent. In fact, in some years, the return may have been very low. In other years, the return may have been more than 20 percent. Investors must plan to hold investments for the long term to achieve substantial growth over time. As a young person, you should set saving and investing goals that focus on the future.

INVESTMENT TRACKING

investment tracking technique for making investment choices by following the prices of stocks over time

Investment tracking is a technique for making investment choices by following the prices of stocks and other investments over time. Stock prices may be tracked on Internet sites and are also shown in many newspapers. You might want to track a stock that interests you for several weeks to see how much the price changes. By tracking stocks and other investment choices over time, you can decide whether you are satisfied with the performance. Then when you are convinced it is a good match with your investment goals, you can buy the stock.

Those who do investment tracking tend to keep data in the form of charts and graphs. These tools allow you to visualize how an investment does over time. They reveal *trends*, or general ups and downs, that can be compared with the performance of other investments under the same conditions.

The chart in Figure 10-3.1 shows changes in the price of a stock over a period of 12 years. In general, the trend is upward, although there are times when the price falls and recovers.

MARKET TIMING

Those who have a good understanding of the economy and general conditions in the financial markets are able to make good investment choices.

Figure 10-3.1 Stock Trend Line

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Market timing involves buying and selling stocks based on what the market is expected to do. Stockbrokers, analysts, and others who make their living buying and selling investments get a good "feel" for when the time is right to buy, hold, or sell. They are able to advise their clients based on experience, trend lines, and analyses. Based on this data, they can match investor goals with investment opportunities. It should be noted that market timing can be risky. This is because not all economic and world events are predictable. The individual investor will develop a certain sense of timing strategy over time. As the investor's wealth continues to grow, he or she becomes more willing (and able) to take greater risks. With greater risk comes greater reward. But if the system fails, then the loss is greater as well.

market timing buying and selling stocks based on what the market is expected to do

DOLLAR-COST AVERAGING

Another strategy for buying stocks or other investments is dollar-cost averaging. With **dollar-cost averaging**, a person invests the same amount of money on a regular basis, such as monthly, regardless of market conditions. The amount is invested regardless of whether stock prices are high or low. Sometimes the investor pays a higher stock price and gets fewer shares. Sometimes the stock price is low and more shares are purchased. Overall, the dollar cost per share may be less than the average price. Using this strategy, investors do not have to study the stock market and try to determine the best time to buy stocks.

dollar-cost averaging investing the same amount of money on a regular basis regardless of market conditions

CHECKPOINT

What is meant by "systematic" saving and investing?

How Can You Reduce Investment Risk?

Individual investors should look for ways they can reduce their overall risks of investing. Diversifying investments and building an investment portfolio can help lessen the risks.

DIVERSIFY

Diversification involves holding a variety of investments for the purpose of reducing overall risk. When one type of investment goes down in value, there may be others that go up. Thus, the losses in one area are offset by the gains in others. It is important for investors to choose more than one type of investment. This is to avoid "having all your eggs in one basket." If a company fails, the investor could lose everything if he or she has only that one investment.

diversification holding a variety of investments for the purpose of reducing overall risk

BUILD A PORTFOLIO

All of a person's savings and investments make up that person's investment portfolio. An **investment portfolio** is a collection of assets that provides diversification for an investor. Investment assets may include certificates of deposit, stocks, bonds, real estate, and other holdings. In order to lower risk over time, the portfolio should be diversified. It should have

investment portfolio a collection of assets that provides diversification for an investor

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...
DOLLAR-COST AVERAGING

The dollar-cost averaging strategy involves the systematic purchase of an equal dollar amount of the same stock at regular intervals. The result is usually a lower average cost per share. For example, an investor purchased $100 worth of stock at various prices every quarter for one year, as shown below. Over that time, the average price of the stock was $8. However, by investing at regular intervals, the investor's average cost per share was lower ($7.41).

Quarterly Investment		Share Price ($)		Number of Shares
$100	÷	$10	=	10
$100	÷	7	=	14.29
$100	÷	5	=	20
$100	÷	10	=	10
$400		$32		54
Total invested				Total number of shares

Average share price = $8 ($32 ÷ 4)

Average cost per share = $7.41 (total invested ÷ number of shares: $400 ÷ 54)

Ending value = $540 (last share price × number of shares: $10 × 54)

Try It Out

You purchased $200 worth of stock every quarter for one year and paid the following share prices: Quarter 1 – $5; Quarter 2 – $10; Quarter 3 – $8; Quarter 4 – $4. Calculate these values: (a) average share price; (b) average cost per share; (c) ending value. Did you benefit from dollar-cost averaging?

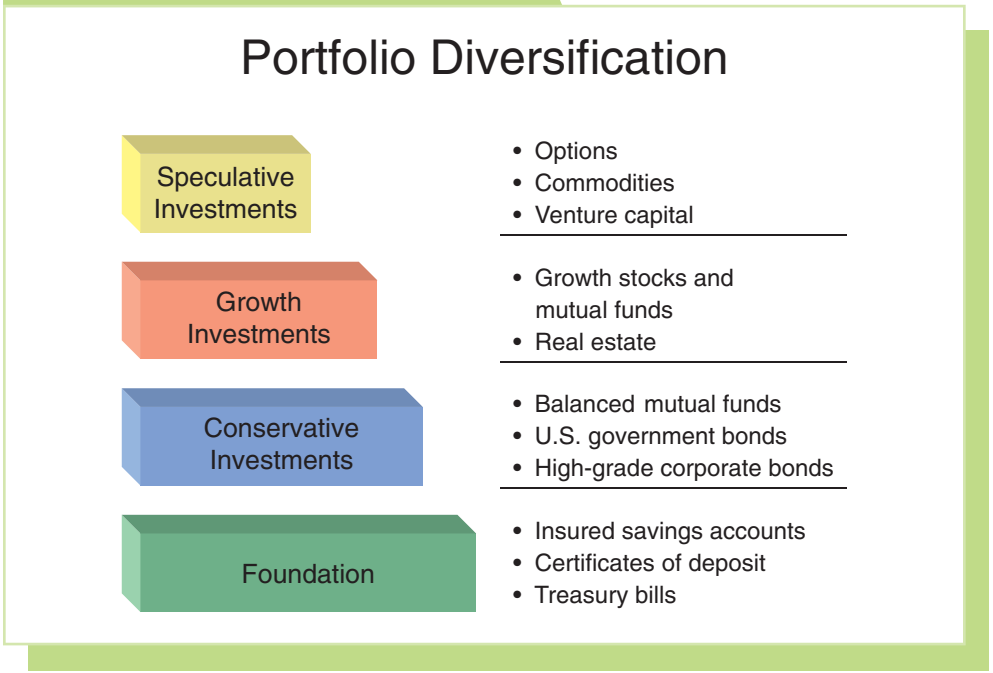
a strong foundation of safe investments. For example, insured savings accounts and certificates of deposit are safe investments. The portfolio should also have some relatively safe, low-risk investments. These might include U.S. savings bonds and conservative mutual funds. A *mutual fund* is a professionally managed collection of stocks, bonds, and other investments. Mutual funds have specific objectives, such as growth (high earnings) or balance (good earnings with acceptable risk). Mutual funds allow investors to have diversified holdings within one investment.

A portfolio could also include some higher-risk choices that have the potential for high returns. Growth stocks and real estate are examples. Some people also include *speculative* investments, which have high earnings potential but carry a high risk. For this reason, some people include only a few or no speculative investments in their portfolios.

Over time, the portfolio should gain in value at a rate greater than the rate of inflation. The investor must decide how much of each type of investment to include. A sample portfolio is shown in Figure 10-3.2. Investment choices will vary based on the person's age, income, family situation, goals, and attitude toward risk. You will learn more about the various types of investments listed in Figure 10-3.2 in Chapter 11.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 10-3.2 A Diversified Portfolio



CHECKPOINT

What is the purpose of diversification?

How Can You Maximize Investment Return?

Having a basic understanding of the market will help you make better investing decisions. The **financial market** refers to any place where investments are bought and sold. There are stock markets and bond markets. There are real estate markets and markets for precious metals such as gold and silver. For most things that an investor may want to buy or sell, a market exists. The term *market* is also used to refer to price levels or other market conditions. For example, the statement "The market was off today" may mean that prices in the stock market were low compared to prices on other recent days.

financial market a place where investments are bought and sold

BULL MARKET

A **bull market** exists in the stock market when prices are steadily increasing. A bull market may last a few months to a few years. During a bull market, price increases are often followed by profit-taking. *Profit-taking* occurs when people who own stocks that have increased in price sell those stocks. This selling activity may cause prices to drop for a while. However, the bull market does not end because a few stocks drop in price. As long as the general trend is toward increasing stock prices, it is still considered a bull market. Bull markets have been common in the last 20 years. Most investors prefer to invest in the stock market when prices are rising.

bull market period in the stock market when prices are steadily increasing

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Why is profit-taking common during a bull market?

When prices are rising, this also may be a good time to sell certain stocks. Suppose a company in which you have stock has been performing poorly in recent months. This could be a sign of poor management or falling demand for the company's products. There could be some other problem that you do not know about. If stock prices in the market overall are rising, the price of this one stock may follow the trend and rise. This could be a good time to sell a stock that you expect to do poorly in the future.

BEAR MARKET

A **bear market** exists in the stock market when prices are steadily decreasing. Bear markets may last from a few months to a year or more. This is a good time to buy stocks that are sound investments because prices are lower. At times in a bear market, there is a lot of buying activity. This can cause a temporary rise in stock prices but does not end the bear market. As long as the general trend is toward declining stock prices, it is still considered a bear market.

bear market period in the stock market when prices are steadily decreasing

ECONOMIC CONDITIONS

Investors should consider economic conditions when forming an investment strategy. There will always be periods of growth and decline in the economy that cause prices to rise and fall. This is a normal part of the market.

When the economy is in a period of general growth, the market for many investments is growing. *Economic growth* is often defined as a period of time when people are working (low unemployment rate), profits are good, wages are rising, and people are optimistic. When a company's profits are rising, its stock prices often rise as well. When this happens with many companies, overall prices in the market rise. Investors who think that the market will continue in a growth trend may choose this time to buy stocks. They think the stocks will grow in value. Investors who think the growth trend is about to end may choose this time to sell stocks. They want to sell at the current high prices before the market begins a downward trend.

When the economy is in a period of general slowdown, the market for investments is declining. Prices may be falling. *Economic decline* can be a good time to buy stocks that you think are sound investments. You can buy while prices are low. This increases your chance of making profits when you sell at some future date. Some investors think it is important not to spend (or invest) everything during an economic growth period. Instead, they wait for a period of decline to buy, taking advantage of lower prices.

CHECKPOINT ▸ ▸ ▸

How is a bull market different from a bear market?

©R. Gino Santa Maria, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

10-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Technique for making investment choices by following the prices of stocks over time

____ 2. Holding a variety of investments for the purpose of reducing overall risk

____ 3. Buying and selling stocks based on what the market is expected to do

____ 4. Strategy that involves regularly setting aside cash that can be used to achieve goals

____ 5. Period in the stock market when prices are steadily increasing

____ 6. Strategy that involves a planned approach to making investments on a regular basis

____ 7. Collection of assets that provides diversification for an investor

____ 8. A place where investments are bought and sold

____ 9. Investing the same amount of money on a regular basis regardless of market conditions

a. bear market
b. bull market
c. diversification
d. dollar-cost averaging
e. financial market
f. investment portfolio
g. investment tracking
h. market timing
i. systematic investing
j. systematic saving

CHECK YOUR UNDERSTANDING

10. Explain how to save and invest using a systematic strategy.
11. Why is having a long-term saving and investment strategy important?
12. What is the advantage of using dollar-cost averaging as an investment strategy?
13. How does diversification lower investment risks?
14. List three types of investments that would be considered low risk.
15. What are some factors that will affect the types of investments a person may need in an investment portfolio?
16. Describe the investment tracking process.
17. When the economy is growing and stock prices are rising, why might an investor sell stocks?
18. When the economy is slowing down and stock prices are falling, why might an investor buy stocks?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. Why does systematic investing begin with systematic savings?
20. Why is systematic investing a long-term plan?
21. Why would you use a chart or graph to display the history of a stock's price over time?
22. Why would an investor choose dollar-cost averaging over market timing or investment tracking?
23. Why should an investment portfolio include a solid foundation of safe investments?
24. Why would an investor choose to invest in speculative stocks or investments? Why should this type of investment be used sparingly?
25. Why do people buy in bull markets and sell in bear markets? Is there a flaw to this strategy? Explain.
26. How does the economy affect investment (buy and sell) decisions?

EXTEND YOUR LEARNING

27. Makenna is 24 years old. She works part time while going to school. She is able to save $50.00 a month. She now has $600.00 in savings. She would like to buy some type of investment that will give her a higher return than a savings account. Makenna is able to save systematically by setting aside $50.00 a month for 10 years or more.
    a. How should Makenna plan to invest (in terms of risk and liquidity) at this point in her life?
    b. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 10. From the data files, open the Excel file *CH10 Future Value*. Look at the example problem provided in the spreadsheet. This investor is making an initial investment of $500.00. An additional $100.00 per month will be invested for 30 years (360 payments). The interest rate is 7 percent. The value of the investment after 30 years will be $126,055.35.
    c. Use the Calculator section of the spreadsheet to enter data for Makenna's investment. Enter *0.08* for an 8 percent annual interest rate.
    d. Makenna wants to leave her investment in place for 10 years. Multiply 10 years times 12 months per year to find the total number of payments. Enter this number in the spreadsheet.
    e. Enter *50.00* as the amount of the monthly payments.
    f. The present value of the investment is $600.00, the initial amount she will invest. Enter the present value amount *600.00* in the spreadsheet.
    g. The maturity value will be calculated automatically. What will be the value of Makenna's investment after 10 years?
    h. If Makenna wants to save at least $15,000 in 10 years, approximately how much will she need to deposit monthly?

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

MARKETING

When a new product is developed for sale, it is the role of marketing to effectively present it to potential buyers. Existing products and services also need promotion so that the business will remain profitable.

Marketing occupations are found in every industry. Marketing managers are creative, energetic, and perceptive. They understand perceptions as well as wants and needs of consumers. They develop pricing and promotional strategies that keep companies profitable while also ensuring that customers' needs are being met.

Small, medium, and large companies use marketing professionals to form a strategic plan that will result in maximizing sales and product development.

Employment Outlook

- Employment growth will be about as fast as average through 2018, increasing by about 13 percent.

Job Titles

- Marketing manager
- Advertising manager
- Promotions manager
- Public relations manager
- Media director
- Account executive
- Creative director
- Marketing research manager
- Sales manager

Needed Education/Skills

- A bachelor's degree in business administration usually is required; a master's degree with emphasis in marketing is preferred.

- Computer skills are essential, along with creativity, motivation, and excellent persuasive speech skills.

What's it like to work in . . . Marketing

Anne works for a marketing firm that does public relations work for corporate clients. She is in charge of developing promotional brochures, pricing strategies, and incentive programs. She currently works on four teams and leads a fifth, which uses her project management skills.

Today, Anne is meeting with her team to prepare a bid to perform the marketing tasks for a new product being developed. She has studied the product and understands the purpose of it and its target audience.

Anne loves her job because it is different every day. She is able to use her creativity and imagination. Her ideas have resulted in successful marketing campaigns and awards for her teams.

What About You?

Are you highly skilled in using the computer for design purposes? Do you like working with teams in a very competitive and creative environment? Would a job in marketing appeal to you?

©Francesco Ridolfi, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 10 Assessment

SUMMARY

10-1 Saving and investing are related because excess money set aside in savings can be used for investing.

Saving and investing provide the funds needed to meet short-term, medium-term, and long-term goals.

Saving and investing provide the means for meeting expenses and enjoying leisure activities during your retirement years. Estate planning will help protect your savings and investments after your death.

10-2 Risk and return are related. Risk-free investments are guaranteed but have low return. High-risk investments offer higher returns.

Return on investment (ROI) is a measurement of the growth of savings and investments. The ROI allows you to compare investment choices.

All investors face investment risks, including inflation risk, industry risk, political risk, and stock risk.

Saving and investing can provide tax advantages when gains are tax-exempt or tax-deferred.

Employer-sponsored retirement plans are tax-deferred and often include a money match, thus maximizing your return.

10-3 Systematic saving is a strategy that involves regularly setting aside cash that can be used to achieve goals. Systematic investing is a strategy that involves a planned approach to making investments.

A saving and investing plan is designed for growth in the long run, not for short-term results.

Investment tracking and market timing are techniques for buying and selling investments, but neither can guarantee results.

Using dollar-cost averaging, a person invests the same amount of money on a regular basis regardless of market conditions or prices.

Investors can reduce their risk through diversification, which involves owning a variety of investments. A portfolio is a collection of diverse investments.

To maximize investment return, investors can sell stocks during a bull market (period when stock prices are increasing), buy stocks during a bear market (period when stock prices are decreasing), and consider the impact of the economy on stock prices.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** In answering each of the following independent situations, round your answers to the nearest whole percent.
   a. John bought stock for $350. A year later, he sold it for $385. What is his return in dollars? What is his return on investment?
   b. Samantha sold her collection of model cars for $600. She had purchased them for $520 a year earlier. What is her return in dollars? What is her return on investment?
   c. Pedro bought 25 shares of a stock for $150 a share. He received dividends of $3 per share each year for 5 years. After 5 years, Pedro sold the stock for $155 a share. What is his return in dollars? What is his return on investment?
2. **Research** Work with two classmates to prepare an oral report. Search the Internet to find stories, biographies, or other data about three successful and wealthy entrepreneurs or businesspersons of your choice.
   a. How did they get started building wealth? Describe their early years, successes, failures, business ventures, and so forth.
   b. Do they participate in or sponsor any foundations or other organizations that benefit others? If so, describe them and their purpose.
   c. Have they published books, articles, media programs, or other items to tell others how to succeed? If so, describe them.
   d. Evaluate each person based on his or her contributions to society, ethics displayed, and methods of accumulating wealth.

3. **Technology** Search the Internet for a savings calculator. Plug in different numbers and note the results. For example, enter a savings amount compounded annually, then quarterly, and then monthly. Note the differences that occur because of the different compounding methods. Then try different savings amounts using the same compounding method. How does saving just a little more each month affect your total savings in, say, ten years? Then try different interest rates with the same savings amounts and compounding method. Summarize your conclusions.
4. **Research** If you inherit money, you may have to pay a state or federal inheritance or estate tax. What tax rates apply in your state and at the federal level? How do these two taxes differ?
5. **Economics** Explain the concept of a business cycle. If the economy is growing, how would that affect your investment choices? If the economy is slowing, how would that affect your choices? Consult *The Economist* magazine and find an article about the business cycle. Where are we at this point in time (recession, recovery, peak, or trough)? Explain what present economic conditions mean in terms of investing.
6. **Social Studies** Access the Internet to learn about foundations and charities that solicit donations from individuals. Select one and create a promotional brochure, including the history of the foundation, what kind of activities it engages in (how it uses the money collected), and how it benefits society.
7. **History** Conduct research about the history of the New York Stock Exchange (NYSE) in New York City. How long has it existed? What is its purpose? What goes on there? Prepare a written report, including a timeline of important events throughout the history of the stock exchange.

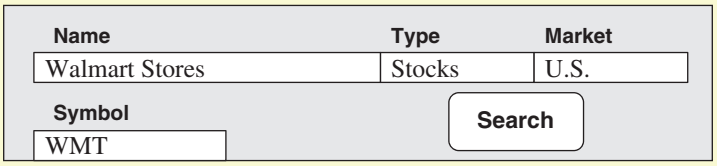
Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Take Action

TRACK STOCK PRICES

Tracking a stock's price for several weeks or months before buying the stock is a common investment strategy. Stock prices are available online and in many newspapers. Typically, the user must enter or find a symbol (a series of letters) that represents the company. For example, the symbol for Walmart Stores is WMT. If you do not know the symbol for a company, you can find it online. You can find symbol search screens, similar to the one below, at many Finance sites. The user enters the name of the company; selects a type of investment, such as stocks; and chooses a market. When the search is complete, the symbol appears.

Sample Symbol Search Screen



Depending on the Internet site or newspaper, various information is provided about the stock. The opening price of the stock, the closing price (also called Last Trade), and any change in the stock price are usually shown, as in the example below.

Walmart Stores, Inc. (WMT)	
Date	3-26-11
Close (Last Trade)	51.13
Change	⇩ 0.54
Previous Close	51.67
Open	51.85

a. Select a large corporation with which you are familiar.

b. Access the Internet and find a site that gives stock quotes. You can find websites by entering the keywords *stock quotes* in a search engine. Search to find the market symbol for the company if you do not know it.

c. Find the Close (Last Trade) price for the stock for the current date. Record the date and the price. Continue to track and record the Close (Last Trade) price of the stock every 1 to 3 days for the following 2 or 3 weeks as your teacher directs.

d. Create a line chart to show the changes in the stock price. Use Figure 10-3.1 as an example for your chart. Use *Days* or *Weeks* instead of Years for your chart.

Include your investment tracking information and line chart in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER 11

Saving and Investing Options

11-1 Low-Risk Choices

11-2 Medium-Risk Choices

11-3 High-Risk Choices

©Yuri Arcurs, 2010/Used under license from Shutterstock.com

Investors can choose among savings and investing options that have low, medium, or high risk. Some of these investment options are more liquid than others. Some can be purchased for a small amount of money. Others can be bought only with large investment amounts. No one investment is likely to meet all your needs. You will learn to consider risk, liquidity, and rate of return as you choose investments for various purposes. Individuals and families have different investment goals at different times during their lives. Making good choices involves an understanding of your financial goals, the risk you are willing and able to assume, and how each potential choice will act and react with market and economic conditions. Then you can begin to make the right saving and investing choices at the right time.

ONLINE RESOURCES

Personal Financial Literacy Website:

www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Game
Chapter 11 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-1 Low-Risk Choices

GOALS

- List low-risk and liquid saving options and discuss their features.
- List low-risk but less liquid investment options and discuss their advantages and disadvantages.

KEY TERMS

- illiquid, p. 344
- early withdrawal penalty, p. 345
- clearing account, p. 347
- discount bond, p. 347
- premium bond, p. 348
- coupon rate, p. 348
- callable bond, p. 349
- convertible bond, p. 349
- zero coupon bond, p. 349
- annuity, p. 351

What Are Low-Risk Savings Options?

Savings is money set aside to meet future needs. Having savings to handle short-term needs and unexpected expenses is especially important. Savings should be in a form that is *liquid*. This means that savings should be in cash or in a savings or investment option that can quickly be changed into cash.

©Jason Stitt, 2010/Used under license from Shutterstock.com

How can a savings account help meet short-term needs?

A checking or savings account in a bank that has no restrictions on withdrawals is an example of a safe, liquid option. It is safe because it is insured by the FDIC. Low return is acceptable because the purposes of the account are liquidity and safety. Keeping a certain minimum balance in a checking or savings account may have other advantages. For example, you may not have to pay bank service fees for the account.

Some investments cannot be changed into cash quickly. Others can be changed quickly but require payment of a penalty for doing so. These investments are said to be **illiquid**, which means they are not convertible to cash quickly or without a penalty. Investors choose these options because they typically pay higher returns than those that are liquid. Many investors seek to balance their investments. They want to have some options that provide higher returns and some that are liquid that can be converted to cash quickly.

illiquid not convertible to cash quickly or without a penalty

SAVINGS ACCOUNTS

A savings account in a bank, credit union, or other insured financial institution is a good option to choose for meeting short-term needs. Savings

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

accounts usually do not have withdrawal penalties. Some or all of the money can be withdrawn at any time. Thus, savings accounts are liquid. However, the account may have some restrictions. For example, the depositor may be able to write only a limited number of checks per month on the account and/or must maintain a minimum balance. A savings account typically pays a low interest rate. The rate is usually higher, though, than for a checking account. A savings account should be considered a safe place to put money.

MONEY MARKET ACCOUNTS

A money market account is another low-risk, liquid savings option. Brokerage firms as well as banks and other financial institutions offer money market accounts. There are two different kinds of money market accounts: money market deposit accounts and money market funds. A *money market deposit account* is similar to a savings account, but it offers a higher rate of interest in exchange for larger-than-normal deposits. A minimum balance, such as $1,000 or $5,000, is often required to maintain a money market account. This type of account pays the market rate of interest. In other words, the rate of interest earned on the account changes with general market conditions. Banks often pay a higher interest rate as your account balance increases. These accounts are insured by the FDIC.

A *money market fund* is a type of mutual fund that invests in low-risk securities (such as U.S. Treasury bills). Money market funds are not FDIC insured, but they are generally considered safe because they invest in short-term government securities. Therefore, the chance of losing your principal (amount deposited) is very low. On average, money market funds will pay a higher interest rate than money market deposit accounts. Before investing in a money market fund, you should carefully read all of the fund's available information.

With money market accounts, you usually are limited to a certain number of withdrawals each month. Because money market accounts offer a more competitive rate, they are a better cushion against inflation than a savings account.

CERTIFICATES OF DEPOSIT

A *certificate of deposit (CD)* is money set aside for a specific length of time at a fixed interest rate. A CD typically pays a higher interest rate than a money market account or savings account. But a typical CD is not a liquid investment. You must pay a heavy penalty if you withdraw the money before the stated time. CDs purchased at banks and credit unions are safe because they are insured by the FDIC. Thus, a CD is a low-risk, illiquid investment. The biggest risk you face with a CD is *inflation risk* because the fixed rate of return may be lower than the cost of living, or the general level of prices. This causes your money to lose value.

Withdrawal Penalties

If you redeem a CD early, you will typically pay a penalty. Be sure to ask about the penalty before you buy a CD. An **early withdrawal penalty** is a fee imposed to discourage depositors from withdrawing the money before the stated time period. The penalty may be 6 months' interest or more. In such cases, you can lose part of your principal if you withdraw money early. Figure 11-1.1 shows an example of the penalty terms for a CD.

early withdrawal penalty a fee imposed to discourage depositors from withdrawing the money before the stated time period

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 11-1.1 Early Withdrawal Penalty

Certificate of Deposit
Amount deposited: $5,000.00
Interest rate: 5% yearly
Term: 5 years

Penalty for Early Withdrawal
If the money is withdrawn before 5 years, the penalty imposed will equal 365 days' interest, whether earned or not.

Sample Scenario
The money is withdrawn after 180 days.

$5,000.00 × 0.05 × 180/365 = $123.29 interest earned
$5,000.00 × 0.05 × 365/365 = $250.00 penalty

$5,000.00	amount deposited
+ 123.29	interest earned
$5,123.29	
− 250.00	early withdrawal penalty
$4,873.29	amount received at early withdrawal

Special Features

CDs pay higher interest when money is set aside for a long period of time. They also pay higher interest for large amounts. A *jumbo CD* is for a large sum of money, usually $100,000 or more, with a term of a year or longer. CDs that pay higher rates of interest often have higher withdrawal penalties. You can earn good interest on this type of CD if you are able to leave your money on deposit for the full term.

Some banks and credit unions allow account holders to invest more money into the CD at the same rate of interest. This feature gives you the opportunity to add money to your account if you are able and if the interest rate is still favorable (earning a rate higher than the rate of inflation). Some financial institutions will also allow you to take part of the money from your CD while leaving the rest in the account. You may be charged a penalty for the portion that is withdrawn early.

Your financial institution may also allow you to "borrow against" your CD. In other words, because you have a CD with the bank, it will lend you money at a lower rate of interest than it would otherwise. Your CD is *pledged*, which means you cannot close out the CD before it matures or before the loan is paid off.

LIFE INSURANCE SAVINGS PLANS

When you buy permanent life insurance, the policy has a savings feature that gains in cash value. Life insurance savings plans provide a low rate of return on your money. Many life insurance policies allow you to borrow money against the policy's cash value. If this loan is not repaid, the life insurance death benefit is reduced by the amount of the loan. Life insurance savings are illiquid. Some people think these plans are a good choice because the built-in savings feature "forces them to save." These investments are only as safe as the company from which you buy. Life insurance savings plans are not insured.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

BROKERAGE ACCOUNTS

You can open an account at an investment company. This account may pay interest like a savings account, or it may be a clearing account. A **clearing account** is used to buy and sell investments. Money is taken from the account to buy them. When they are sold, money is put back into the account. Clearing accounts typically earn low rates of interest.

clearing account an account used to buy and sell investments

Brokerage accounts are not insured. However, they are considered low-risk when placed with a reputable investment company. A brokerage account is liquid and works a lot like a checking account. There may be restrictions such as a limit to the number of checks you can write in a month or year. Interest earnings are usually higher than for checking or savings accounts in banks, but the risk is higher as well.

CHECKPOINT

Give three examples of liquid savings options.

What Are Low-Risk Investing Options?

Investments vary in term, risk, rate of return, and relative liquidity. Options that are low risk typically pay a lower rate of return than those with higher risk. Options that are long term typically pay higher rates than those that are short term.

To be liquid, an investment must be easily converted to cash. There should also be no significant loss of the amount invested. Whether or not an investment is liquid depends on several factors. If there are investors who are willing to buy when you wish to sell an investment, then the investment can be turned into cash quickly. However, there is no guarantee that the selling price will be higher than the price you paid for the investment. Thus, you could lose part of the amount invested. If there are no investors who are willing to buy the investment when you want to sell it, you will not be able to get cash quickly.

Some investments are considered very safe because they are insured. Others that are not insured are also considered fairly safe. This is because the company or government body issuing them is financially sound.

BONDS

Bonds are issued by corporations and governments. A *bond* is basically a loan that a buyer makes to a bond issuer. Thus, it is a form of holding debt as an investment. Some bonds are sold at face value. The *face value* is the amount the bondholder will be repaid on the *maturity date* (the date the borrowed money must be repaid). Other bonds are sold at a discount or a premium. A **discount bond** is one that is sold for less than its face value. For example, if the face value of the bond is $5,000 and you pay $4,900, the discount is $100. Bonds may be sold at a discount to increase the overall profit from the bond and to make the bond more attractive to investors.

discount bond a bond that is sold for less than its face value

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

premium bond a bond that is sold for more than its face value

A **premium bond** is one that is sold for more than its face value. Some bonds are very attractive to investors, perhaps because they are safer than other choices yet pay a good interest rate. These bonds may sell at a premium.

Corporate Bonds

Corporate bonds are issued by corporations to raise money. Bonds are a form of borrowing for the company. The money is used for various purposes, such as building new factories or buying equipment. Corporate bonds pay a **coupon rate**, which is the fixed rate of interest that is paid semiannually for the life of a bond. The rate is set at the time the bond is issued and typically does not change. The interest is subject to income tax. Many people invest in corporate bonds to receive regular (semiannual) interest payments. At maturity, the bond can be redeemed for face value.

coupon rate the fixed rate of interest that is paid semiannually for the life of a bond

Corporate bonds are typically offered for sale in multiples of $1,000 or $5,000, and they have various terms to maturity. Corporate bonds with terms of up to two years are short-term bonds. Bonds with terms from three to ten years are medium-term bonds. Bonds with terms of more than ten years are long-term bonds. Corporate bonds can be purchased at a discount. Figure 11-1.2 illustrates how you can make money buying a corporate bond at a discount. When you redeem the bond, you must pay taxes on the interest as well as on any gains you make. In Figure 11-1.2, you would pay taxes on the $400 interest earned and on the $200 gain you realized from the discount.

Figure 11-1.2 Return on a Corporate Bond

Corporate Bond

Face value: $5,000
Discount rate: 4%
Coupon rate: 4% yearly (paid semiannually)
Term: 2 years

Purchase price:
$5,000 × 0.04 = $200 discount amount
$5,000 − $200 = $4,800 discounted purchase price

Semiannual interest:
$5,000 × 0.04 = $200 interest per year ($100 semiannual payment)
$200 × 2 years = $400 total interest received

Return on investment:
At the end of the second year, the bond is redeemed for $5,000 (face value).

$ 5,400 total amount received ($5,000 face value + $400 interest)
−4,800 amount invested
$ 600 total profit in dollars

$600 ÷ $4,800 = 0.125 = 12.5% total return on investment

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

A bond may be callable. For example, if interest rates are dropping, corporations may choose to call the bonds because they can re-issue them at a lower interest rate. A **callable bond** has a clause that allows the issuer to repay the bond early (before the maturity date) at a set amount. The amount is typically higher than the face value of the bond. However, the total amount of interest received will be less than if the bond was held until its maturity date. If interest rates have been dropping, you may not be able to reinvest the money you receive from the bond at the same rate. The amount you receive for the bond could also be less than the price for which you could sell the bond. Because of these risks, callable bonds typically pay a higher coupon rate than other similar bonds or are issued at a discount.

callable bond a bond with a clause that allows the issuer to repay the bond early

A **convertible bond** is one that can be exchanged for shares of common stock at the option of the bondholder. If you see that the company is doing especially well and/or you are willing to take more risk, you can exchange your bond for an equivalent number of shares of stock. This feature is attractive to investors because it gives them flexibility.

convertible bond a bond that can be exchanged for shares of common stock at the option of the bondholder

Another type of corporate bond is the zero coupon bond. A **zero coupon bond** is a discount corporate bond that does not provide the typical semiannual interest payments. The bond is sold at a deep discount and grows in value over time. You receive the face value of the bond at maturity. For example, you might buy a zero coupon bond for $12,000. In ten years, at the maturity date, you might redeem the bond for $19,000. This type of bond can be a good way to invest for a particular long-term need, such as paying for a child's education.

zero coupon bond a discount corporate bond that does not provide the typical semiannual interest payments

Some corporate bonds are considered low-risk investments; others are not. The risk depends on the issuing company's ability to make interest payments and repay the bond. Bond rating services study the financial health of bond issuers. They assign risk ratings to the bonds offered for sale. Investors can use these ratings to judge the risk of buying a bond. Standard & Poor's Corporation is an example of a company that provides ratings for bonds.

Investment-grade bonds have high ratings (AAA, AA, A, and BBB) and are considered fairly low-risk. *Speculative-grade bonds* have low ratings (BB and lower). These bonds are sometimes called *junk bonds* or high-yield bonds. They are considered medium to high risk. However, they are attractive to some investors because they pay higher interest rates than investment-grade bonds. In general, corporate bonds carry a higher risk than government bonds but provide a higher return.

Government Bonds and Securities

Government bonds and securities are issued by the U.S. Treasury or by U.S. government agencies. They can be a good way to invest and save for the future. They are low-risk when held to maturity. The interest earned from most of these investments is subject to federal taxes but not state and local taxes. Thus, these bonds make a good tax shelter. A *tax shelter* is an investment that allows you to legally avoid or reduce income taxes.

©Sai Yeung Chan, 2010/ Used under license from Shutterstock.com

Why are some corporate bonds rated?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

There are many options for individual investors, including savings bonds, Treasury bills, Treasury notes, Treasury bonds, and TIPS. You can open a TreasuryDirect account online at www.treasurydirect.gov where you can purchase, manage, and redeem any of these government bonds and securities.

- *Series EE Savings Bonds*. These bonds are safe, low-risk products that pay a fixed interest rate for up to 30 years. Interest is added to the bond monthly and paid when the bond is redeemed. Paper EE bonds are bought at half the face value (you pay $25 for a $50 bond) while electronic bonds (purchased at TreasuryDirect) sell at face value. The minimum purchase is $25. The bonds can be redeemed after one year, but there is a penalty if redeemed before five years. Interest earnings are subject to federal income tax unless used to finance education.
- *I Savings Bonds*. These bonds are a low-risk, liquid savings option. While you own them, they earn interest to protect you from inflation. Their interest rate is made up of fixed and variable rates. The variable rate is adjusted annually based on the current inflation rate. Interest is added monthly and paid when the bond is cashed. I savings bonds are purchased at face value with a minimum purchase of $25 and a maximum yearly purchase of $5,000. The bond pays interest up to 30 years, and the minimum term of ownership is one year. As with EE bonds, there are early redemption penalties for the first five years. Interest earnings are subject to federal income tax unless the earnings are used to finance education.
- *Treasury Bills*. Known as T-bills, these securities are sold in terms ranging from 4 to 52 weeks. T-bills are sold at a discount from the face value. You might pay $990 for a $1,000 bond. When the bill matures, you receive the $1,000. The difference between the face value and the purchase price is the interest you earn. There is no minimum term of ownership.
- *Treasury Notes*. Known as T-notes, these securities are sold in terms of two to ten years at a fixed rate of interest, which is paid every six months until maturity. The fixed rate is determined at the time the note is issued. The minimum purchase is $100. There is no minimum term of ownership.
- *Treasury Bonds*. These bonds are available for a minimum purchase of $100 and have a 30-year term. They pay interest every six months until they mature. Interest rates are generally higher than for T-bills or T-notes because of the longer term. There is no minimum term of ownership.
- *Treasury Inflation-Protected Securities (TIPS)*. These securities are guaranteed to keep pace with the rate of inflation as measured by the Consumer Price Index (CPI). The face value of the TIPS increases with inflation (and decreases with deflation) as measured by the Consumer Price Index (CPI). When the TIPS mature, you are paid the adjusted face value or the original face value, whichever is greater. Interest is paid twice a year, at a fixed rate, on the adjusted face value. Thus, interest payments rise and fall. TIPS are issued in terms of 5 to 30 years, and the minimum purchase is $100. There is no minimum term of ownership.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

BAD NEWS MESSAGES

A *bad news message* is one that the reader will not find favorable or will not be happy to receive. When writing a message that is bad news, use an indirect approach. With an indirect approach, the writer attempts to break the news gently and keep the reader's goodwill.

In the first paragraph, state or refer to the issue or decision to be made. Give facts or logical reasoning to support the denial or other unfavorable news. Your goal is to convince the reader that the decision is the right one even before the decision is stated. The bad news comes only after the reader is prepared to hear it.

In the second paragraph, state the denial or other bad news. Bad news can often be cushioned by talking about what can be done, rather than just stating what cannot be done. Make the explanation clear and logical. Give details as needed. Use a positive tone throughout the letter.

In the third paragraph, state action you want the reader to take, if it applies to the situation. Close the letter on a positive note. For example, thank the reader for his or her business, or mention a project you will work on together in the future. The message should make the reader feel important and that her or his concerns have been considered. Your goal is to have the reader accept the news and keep the reader's goodwill.

Try It Out

You are a financial adviser. Write a letter to a client explaining that he has incurred a loss on the sale of a corporate bond because the issuing corporation is financially unstable. Convince the client that it is best to take the loss and focus on better investment opportunities.

State and Local Securities

Municipal bonds are issued by states, counties, cities, and towns. They are used to pay for projects, such as roads or public buildings. You do not have to pay federal, state, or local taxes on the income from many municipal bonds. Municipal bonds are rated to help investors evaluate the risk involved. Many municipal bonds are considered low-risk. Although it is possible for a government unit to go bankrupt, it is not very likely. The tax shelter feature of these bonds also makes them attractive.

ANNUITIES

An **annuity** is a contract purchased from an insurance company that guarantees a series of regular monthly payments for a set time. To buy an annuity, you would pay a monthly payment into the account for a set number of years (such as 20). You could also invest a lump sum. Then at the end of the set number of years, the annuity would start paying you monthly payments. Many people who buy annuities use them as a source of retirement income. They are fairly safe, but only as safe as the company with which you invest. Annuities are not insured. They may be tax-deferred, which means the interest can grow without being taxed. You will be taxed when you receive the monthly payments.

annuity a contract purchased from an insurance company that guarantees a series of regular monthly payments for a set time

CHECKPOINT

List three types of government savings bonds or securities.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. An account used to buy and sell investments

_____ 2. A discount corporate bond that does not provide the typical semiannual interest payments

_____ 3. A bond with a clause that allows the issuer to repay the bond early

_____ 4. A fee imposed to discourage depositors from withdrawing the money before the stated time period

_____ 5. The fixed rate of interest that is paid semiannually for the life of a bond

_____ 6. Not convertible to cash quickly or without a penalty

_____ 7. A bond that can be exchanged for shares of common stock at the option of the bondholder

_____ 8. A bond that is sold for less than its face value

_____ 9. A bond that is sold for more than its face value

a. annuity
b. callable bond
c. clearing account
d. convertible bond
e. coupon rate
f. discount bond
g. early withdrawal penalty
h. illiquid
i. premium bond
j. zero coupon bond

CHECK YOUR UNDERSTANDING

10. Explain why having liquid savings is important.
11. Why is a savings account considered a low-risk savings option?
12. How are money market deposit accounts and money market funds different from savings accounts?
13. Why is a CD more illiquid than a money market account?
14. Explain the purpose of early withdrawal penalties for CDs.
15. Why do some CDs pay higher interest rates than other CDs?
16. What is the purpose of an I savings bond?
17. How are T-bills different from T-notes?
18. How are corporate bonds different from government bonds?
19. Explain how an annuity can help provide financial security during retirement.
20. How can an investment be considered low-risk if it is not insured?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

21. Why is it important to make some low-risk investments that are illiquid?
22. Why would you select a money market account over a savings account?
23. Why are money market funds with brokerage firms considered more risky than money market deposit accounts held at banks or credit unions?
24. Why would an investor choose to take an early withdrawal penalty?
25. Why would you choose to borrow money against your CD?
26. Why is a savings plan in a life insurance policy considered a poor savings option? Why might an individual choose this option?
27. Why is a Series EE savings bond considered a good method to save for your children's college education?
28. Series EE savings bonds carry a fixed rate of interest while I savings bonds have a variable rate component. Which is better? Why?
29. When a bond sells at a discount, do you pay more or less than the face value of the bond? Why might a bond issuer sell the bond at a discount?
30. Why might investors choose corporate bonds over government bonds?
31. Why might investors choose government bonds over corporate bonds?

EXTEND YOUR LEARNING

32. Many people start investing with short-term and low-risk choices. They want the investments to be liquid so that they can get their money quickly if needed. In the two cases below, consider the risk and liquidity of savings and investing options. Give advice to each of the investors.
    a. Lee is working full time. He started his first job six months ago. He pays his bills and has $300 a month remaining. Rather than spend this money, Lee has decided to set it aside for the future. He has signed an annuity contract whereby he will pay $300 a month for the next 20 years. Then he will start receiving payments from the annuity, or he can leave the money there to gain more earnings until he retires. He has no savings account or other investments at this point. Has Lee made a good investment choice? Are there other options that might be better for him to consider for his portfolio at this time?
    b. Juanita is working part time while she goes to college. Because she has a scholarship, she is able to save $50 a month. Juanita has decided to leave the $50 she saves each month in her checking account. While the account does not pay interest, she is able to avoid a monthly service fee of $8 because she has enough money to meet minimum deposit requirements. What do you think of Juanita's decision? Are there other good options that she might consider for saving or investing her money?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-2 Medium-Risk Choices

GOALS

- List and describe investment choices in financial markets.
- List and discuss retirement accounts and options available to individual investors.
- List and describe retirement accounts available through employers.

KEY TERMS

- mutual fund, p. 354
- indirect investing, p. 355
- asset allocation, p. 355
- traditional IRA, p. 358
- Roth IRA, p. 358
- spousal IRA, p. 358
- Keogh account, p. 358
- 401(k) plan, p. 359
- 403(b) plan, p. 359
- rollover, p. 360

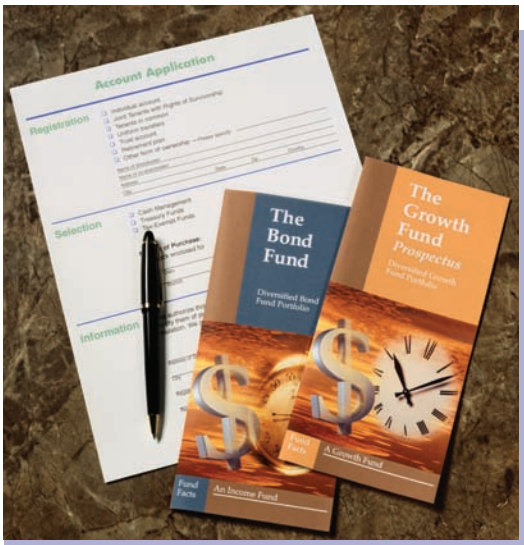
What Are Good Financial Market Investments?

In order to earn a higher return, investors must be willing to take some risk. Medium-risk investments will increase your return without raising the risk beyond reason. With many medium-risk choices, the investor can choose how much risk he or she is willing to take. When investors first get started, they may be wise to use the services of financial experts rather than make investments in the financial market directly. Most medium-risk investments should be monitored carefully over time. As your goals change, you may wish to choose different mutual funds, property, or other investment strategies.

MUTUAL FUNDS

mutual fund a professionally managed group of investments bought using a pool of money from many investors

A **mutual fund** is a professionally managed group of investments bought using a pool of money from many investors. Mutual funds consist of stocks, bonds, and other investments. Because mutual funds contain a variety of investments, they are diversified, which lowers your risk. Each fund is focused on a specific investment strategy or objective. An investor buys shares in the fund with the strategy that best matches the investor's goals and risk comfort level. Mutual funds are often thought of as a good way to get started with medium-risk investments.



Photodisc/Getty Images

Why is it a good idea to begin investing with a mutual fund?

Buying mutual funds is a form of indirect investing.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

With **indirect investing**, you are buying shares of a mutual fund instead of buying individual shares of stock in various companies. In other words, you own shares of the mutual fund; you do not own the shares of the stock of the companies in which it invests.

indirect investing buying shares of a mutual fund instead of buying individual shares of stock in various companies

A mutual fund company is in the business of buying and selling. The fund's managers are watching companies and markets. When you invest your money with a mutual fund company, you are paying for the firm's expertise. Thus, you don't have to spend your time following the stock market and looking for good investments. The fund's managers select the combination of investments they think is the best to meet the fund's goals. Figure 11-2.1 describes various types of mutual funds by their objectives.

With mutual funds, the investor can exercise **asset allocation**, which involves choosing a combination of funds within a single mutual fund company. The investor can pick investments that have a variety of risks. An example of asset allocation is shown in Figure 11-2.2.

asset allocation choosing a combination of funds within a single mutual fund company

Figure 11-2.1 Mutual Fund Types

Mutual Fund Type	Description
Balanced funds	Invest in a diversified portfolio that includes some low-risk, some medium-risk, and some high-risk stocks. These funds strive for balance between growth and income. The objective is to reduce overall risk while maximizing return.
Bond funds	Invest primarily in bonds. If the bonds are tax-free, this advantage is passed along to investors.
Global funds	Invest in international companies, new industries in foreign countries, and companies in the world marketplace.
Growth funds	Invest in companies that are expected to grow over the long run. Gains will be made when the companies reach their potential. They are often considered to be high-risk investments in the short run.
Income funds	Invest in bonds and stocks that produce steady and reliable dividend and interest payments that are passed along to investors.
Index funds	Invest in securities to match a market index with the goal of having returns similar to those of that index.
Money market funds	Invest in short-term securities that go up or down with current interest rates and the economy.
New venture funds	Invest in new and emerging businesses and industries. These are considered high-risk (but also high-return) choices.
Precious metal funds	Invest in companies that are associated with precious metals, such as gold, silver, and platinum.
Stock funds	Invest primarily in stocks. They could be categorized into types of stocks—blue chips, technology, medical, etc.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 11-2.2 Asset Allocation in a Mutual Fund

ASSET ALLOCATION		
Percentof Holdings	**Type of Fund**	**Reason for Choice**
20%	Bond fund	For stability and to offset risk of other funds
20%	Growth fund	To invest in high-risk choices that could grow greatly over time
20%	Global fund	To benefit from world economic growth
20%	Money market fund	To provide liquidity and short-term gains
15%	Income fund	To receive income in the form of dividends
5%	New venture fund	To invest in emerging, young businesses that could become highly profitable and provide a high return

PERSONAL RESIDENCE

Most financial experts believe that buying your own home is the best investment you will ever make. They also agree that home ownership is not always liquid. You must be willing to wait to sell when the market is on the upswing. Because the costs of buying are so high, it usually takes several years to make a profit. When you own your own home, you should take good care of it to protect your investment. Over the long run, home ownership is a fairly safe investment, with value that often grows faster than the rate of inflation.

Owning your own house is a good tax shelter. Gains realized from the sale of your home can be tax-free if you meet the IRS requirements. For example, the first $250,000 of gain are excludable (not subject to tax) when you sell your personal home (the one in which you reside). (That's $500,000 for a married couple.) To qualify, you must have owned and lived in the home for at least two years out of the five years prior to its sale. There are exceptions to the two-year ownership rule, including health considerations and unforeseen circumstances.

Any gain beyond the excludable amount on your home is subject to *capital gains tax*. If you owned your home for a year or less, it's a short-term capital gain, which is taxed at regular income tax rates. If you owned the property longer than a year, the current maximum capital gains tax is 15 percent. For example, assume you bought your house for $200,000 and sold it for $600,000. That's a gain of $400,000. If you qualify, you would have no tax on the first $250,000 (or $500,000 if married). The remaining $150,000 would be taxed at 15 percent, or a tax of $22,500 (or if married, the entire gain is tax-free).

CHECKPOINT ▸ ▸ ▸

How does indirect investing lower your risk?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

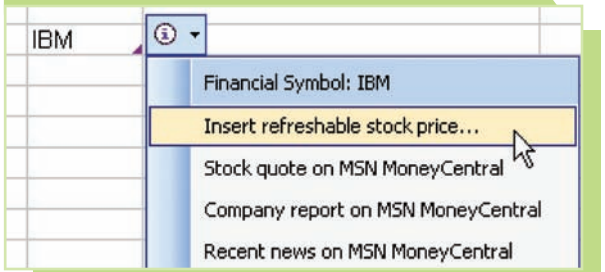
Success Skills

TRACKING INVESTMENTS USING A SPREADSHEET

People who buy investments such as mutual funds should check the progress of their investments often. A good way to do this is to set up a spreadsheet that shows purchase price, monthly or yearly change in value, percentage change in value, and ending value. This allows you to track each investment over time. It also allows you to compare investments. Most importantly, it helps you to decide when it is time to change your investment strategy. If one type of investment is going steadily down in value over time, or not increasing as fast as others, it may be time to make a change.

Microsoft Excel® has a feature that allows you to get updated stock quotes. If you want to see the prices of several stocks or mutual funds each day or week, this feature can save you time. Simply enter the recognized symbol for a stock in the worksheet. Click outside the cell, and then click the *Smart Tag* that appears. (The Smart Tag feature must be turned on.) Choose *Insert refreshable stock price* from the menu, as shown in Figure 11-2.3. Select a location for the quote and related information to appear and click *OK*. You must be connected to the Internet to access stock quotes.

Figure 11-2.3 Refreshable Stock Quotes



Try It Out

1. Choose five different investments from a local paper or online, such as three stocks, a mutual fund, and a CD. Invest a total of $15,000 ($3,000 in each). Enter the stock symbols into an Excel spreadsheet and keep track of the progress of the investments over a set period of time, such as a month.
2. At the end of the month, compare the current values of each investment to the initial price or cost. Evaluate your choices—which one was the best? The worst?

What Are Individual Retirement Account Options?

A retirement account is a good way to save for the future. You can open a retirement account as an individual. You deposit funds in an account to be withdrawn at retirement. You must manage the account by choosing the types of investments in the account. Earnings on the investments remain in the account, allowing them to compound and grow faster. These investments are considered to be medium-risk. Individual retirement accounts offer either a tax-deferred or tax-free way of saving for retirement, making them excellent tax shelters.

IRA ACCOUNTS

An *IRA (individual retirement account)* allows individuals to deposit money into an account during their working years for withdrawal upon retirement. IRAs can be set up at banks and other financial companies, but they are managed by the investor. IRAs are a good long-term plan for providing retirement income.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

The amount that can be set aside in an IRA is limited, based on your income. The maximum annual IRA contribution in 2010 was $5,000. This amount changes periodically. You can begin withdrawing money from an IRA at age 59½ or later. If money is withdrawn before age 59½, it is taxed at regular rates and is subject to a 10 percent early withdrawal penalty. There are exceptions, such as withdrawals for medical expenses or education.

Traditional IRA

traditional IRA an individual retirement account that allows individuals to contribute pretax income to an account that grows tax-deferred

A **traditional IRA** is an individual retirement account that allows individuals to contribute pretax income to an account that grows tax-deferred. You will not have to pay taxes on contributions to the account or the account's earnings until the money is withdrawn during retirement. In addition, the money you contribute is deductible from gross income if certain requirements are met. This lowers your taxable income and income tax. Withdrawals from a traditional IRA must begin by age 70½.

Roth IRA

Roth IRA an individual retirement account in which contributions are taxed, but earnings are not

A **Roth IRA** is an individual retirement account in which contributions are taxed, but earnings are not. You cannot deduct the amount you contribute from your gross income. However, if you meet certain requirements, the earnings on a Roth IRA are tax-free. Thus, when you retire, the money you withdraw will not be taxable. You can choose the types of investments for a Roth IRA. No minimum distribution rules apply. Unlike a traditional IRA, you do not have to begin withdrawals from a Roth IRA at age 70½.

Spousal IRA

spousal IRA an individual retirement account set up to benefit a spouse who has no income

Keogh account a tax-deferred retirement plan for self-employed professionals

A **spousal IRA** is an individual retirement account set up to benefit a spouse who has no income. The working spouse can contribute money to the non-working spouse's account. A spousal IRA can be set up as a traditional or Roth IRA. The contribution limits are the same as for other IRAs. To qualify, couples must file a joint tax return.

SEP ACCOUNTS

The *SEP (simplified employee pension)* plan is a tax-deferred retirement plan for small business owners and their employees. It is similar to an IRA and is often called a SEP-IRA. The amount of money that can be set aside is higher for a SEP than for an IRA. There are no IRS filing or paperwork requirements to establish a SEP. The employer chooses a financial institution and sets up an IRA for each eligible employee. Then the employer makes a contribution to the IRAs of up to 25 percent of the employee's salary. As with other types of IRAs, the investor (employee) chooses how the money will be invested among various investment options. Self-employed individuals can also establish a SEP.

©Ryan R Fox, 2010/Used under license from Shutterstock.com

Why should young people consider a Roth IRA?

KEOGH ACCOUNTS

A **Keogh account** is a tax-deferred retirement plan for self-employed professionals. It is also available to their employees. It is similar to a SEP, but it is more complex

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

to establish. Some types of Keogh accounts have higher contribution limits than SEPs do. Up to $195,000 can be contributed each year. Thus, Keoghs are used more often by higher-income business owners, such as doctors, lawyers, and accountants. Contributions are tax-deductible. Like other retirement accounts, a Keogh account is managed by the investor.

CHECKPOINT

Why might someone want to open an individual retirement account?

What Retirement Plans Are Available through Employers?

Many employers provide some type of retirement plan for their employees. Often it is part of the employee's benefits package. You can set aside money pretax and defer taxes until the money is withdrawn. In some cases, the money you set aside may be matched by money contributed by the employer (as described in Chapter 10). An employer-sponsored retirement plan is a good option for providing retirement income.

DEFINED-CONTRIBUTION PLANS

A *defined-contribution plan* is an employer-sponsored retirement plan in which employees can receive a periodic or lump-sum payment based on their account balance and the performance of the investments in their account. Employees are not promised a specific amount of benefits at retirement. Employees pay a set amount or percentage of their salary into a retirement account each month, which is then invested. When employees retire, they are paid a benefit based on contributions made to the account and investment gains or losses.

401(k) Plans

One type of defined-contribution plan is the **401(k) plan**, which is a tax-deferred retirement plan funded by employees of profit-seeking businesses. The employee sets aside money each month with a pretax payroll deduction. There is a limit to the amount the employee can contribute. Employer contributions are optional. Employees can choose investments for their 401(k) fund based on their goals and willingness to take risk. These accounts and their earnings are not taxed until the money is withdrawn. At retirement, withdrawals are taxed as ordinary income. Early withdrawal penalties apply to 401(k) accounts.

401(k) plan a tax-deferred retirement plan funded by employees of profit-seeking businesses

403(b) Plans

Another type of defined-contribution plan is the **403(b) plan**, which is a tax-deferred retirement plan funded by employees of government and nonprofit organizations. Teachers, school staff, nurses, doctors, professors, librarians, and ministers are examples of people who may qualify for a 403(b) plan. Money is set aside by workers through pretax payroll deductions. It is not matched by employers. Employees are allowed to

403(b) plan a tax-deferred retirement plan funded by employees of government and nonprofit organizations

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NET Bookmark

Planning for your retirement is important. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 11. Review the top five ways to get started with a retirement plan. Name the five steps. Why should you begin saving early? What are the benefits of a 401(k) plan? Why should you participate in an employer-matching program?

www.cengage.com/school/pfinance/pfl

choose investments for the money deposited. Earnings and contributions are not taxed until the money is withdrawn.

DEFINED-BENEFIT PLANS

A *defined-benefit plan* is an employer-sponsored retirement plan in which retired workers receive a set monthly or lump sum payment based on their wages earned and number of years of service. A pension plan is an example of this type of plan. The retirement accounts in a pension plan are often funded entirely by the employer. Employees do not make choices about investments. Typically, employees must work for the company for a certain number of years to qualify for or become *vested* in the plan. Once vested, the employee cannot lose the account when he or she leaves the job.

The retirement benefit payment varies, depending on the number of years worked, the worker's salary, and other factors. The plans are tax-deferred. Employees pay taxes on the money when received after retirement.

Pension plans are offered by fewer companies now than in the past. These plans are disappearing, because employers must make pension payments even when the investments in the plan do poorly or lose value because of poor economic conditions.

PORTABILITY

rollover the process of moving a retirement account balance to another qualified account without incurring a tax penalty

Most retirement accounts are *portable*—you can take the account with you when you leave a job. A **rollover** is the process of moving a retirement account balance to another qualified account without incurring a tax penalty. For example, you may be working for a company that has a 401(k) or a 403(b) retirement account. If you leave your job, you can take the money you contributed with you. If the account is vested, you can also take with you the money your employer contributed. You can roll over your 401(k) to an individual IRA account or to an account provided by a new employer. Taxes will be deferred until withdrawals are made. Rollovers have a time limit and other restrictions.

CHECKPOINT

How is a 401(k) plan different from a 403(b) plan?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A tax-deferred retirement plan funded by employees of profit-seeking businesses

____ 2. An individual retirement account in which contributions are taxed but earnings are not

____ 3. The process of moving a retirement account balance to another qualified account without incurring a tax penalty

____ 4. A professionally managed group of investments bought using a pool of money from many investors

____ 5. A tax-deferred retirement plan for self-employed professionals

a. 401(k) plan
b. 403(b) plan
c. asset allocation
d. indirect investing
e. Keogh account
f. mutual fund
g. rollover
h. Roth IRA
i. spousal IRA
j. traditional IRA

____ 6. Buying shares of a mutual fund instead of buying individual shares of stock in various companies

____ 7. An individual retirement account set up to benefit a spouse who has no income

____ 8. An individual retirement account that allows individuals to contribute pretax income to an account that grows tax-deferred

____ 9. Choosing a combination of funds within a mutual fund company

CHECK YOUR UNDERSTANDING

10. Explain why mutual funds are a form of indirect investing.
11. Give two advantages of buying mutual funds rather than individual stocks or bonds.
12. What is the purpose of asset allocation?
13. Which type of mutual fund has a better potential for high returns: a bond fund or a stock fund? Which of these two funds has a higher risk?
14. List three types of retirement accounts that can be opened by an individual.
15. How are traditional IRAs and Roth IRAs similar? How are they different?
16. What types of retirement accounts are available to the self-employed?
17. List three types of employer-sponsored retirement plans.
18. What is the advantage of having a tax-deferred investment account?
19. Why is having a retirement account that is portable important?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is investing in mutual funds a good way for beginning investors to get started?
21. Why is owning your own home a good investment for most people? Explain the concept of tax shelter as it relates to this investment.
22. Which type of IRA is most desirable for young people? Explain.
23. If available, why should you start setting money aside in a SEP, Keogh, 401(k), or 403(b) account as soon as you begin working?

EXTEND YOUR LEARNING

24. Three types of mutual funds are described below.

    Balanced Fund: This fund seeks current income, long-term growth of capital and income, and preservation of capital. This is a low-risk fund.

    Index Fund: This fund seeks above-average returns by investing primarily in stocks. The fund's risk profile is similar to that of the Standard & Poor's 500 Index. This is a medium-risk fund.

    Growth Fund: This fund seeks long-term gains by investing at least 80 percent of its assets in stocks of companies with above-average earnings growth. This is a high-risk fund.

    Returns for each fund over eight years are shown in the following table:

Year	Balanced Fund	Growth Fund	Index Fund
2003	14.01%	6.53%	28.84%
2004	3.89%	58.17%	12.37%
2005	−1.83%	−13.52%	−7.75%
2006	−5.23%	−33.59%	−10.87%
2007	−18.91%	−24.88%	−22.85%
2008	18.21%	34.83%	23.67%
2009	6.78%	4.94%	8.78%
2010	6.84%	11.82%	7.60%

Point Your Browser

www.cengage.com/school/pfinance/pfl

a. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 11. From the data files, open the Excel file *CH11 Funds Data*. This file contains the returns data for the three mutual funds as shown in the table. Create a line chart or a column chart to compare the returns data for the three funds. (If you do not have *Excel* or other spreadsheet software, create a chart manually using graph paper.)

b. Use *RETURNS COMPARISON* for the chart title. Include a legend to identify the line or column for each fund.

c. Which fund had the highest return in any one year? Which fund had the lowest return in any one year? Which fund had the smallest amount of change over the years? Which two funds had similar returns? Which fund would you choose and why?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-3 High-Risk Choices

GOALS

- Explain the concept of direct investing in financial markets, including in stocks, futures contracts, and commodities.
- Describe how you can invest in business ventures, including starting or buying a business.
- Discuss other high-risk investment choices, including real estate, collectibles, and precious metals and gems.

KEY TERMS

- direct investing, p. 363
- common stock, p. 364
- preferred stock, p. 364
- futures contract, p. 364
- commodity, p. 364
- investment club, p. 365
- franchise, p. 366
- collectibles, p. 369
- precious metals, p. 369
- gems, p. 369

How Can You Invest Directly in Financial Markets?

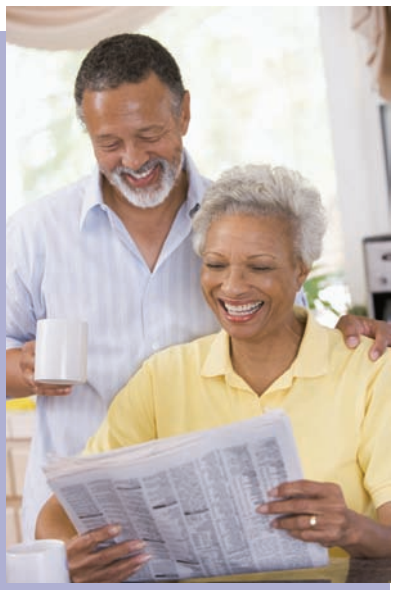
Buying stocks and other investments directly from companies and holding them is known as **direct investing**. If you buy only the stock of one company and hold that stock, you are taking a high risk because you have invested your money in one place. You are not spreading the risk. You can lower your risk by buying many different types of stocks. You can learn more about making direct investments in stocks at the U.S. Securities and Exchange Commission website (www.sec.gov). The primary function of the SEC is to protect investors who buy stocks from publicly traded companies.

direct investing buying stocks and other investments directly from companies and holding them

BUYING STOCKS

When you buy stock in a corporation, you become a stockholder. A *stockholder* owns shares of the company. Stockholders make money in two ways. One way is by receiving dividends. The other way is by selling the stock at a price that is higher than the price paid for the stock. This increase in selling price is referred to as *growth* (in value).

A stock that pays annual dividends is attractive to an investor who needs the income (such as at retirement). Buying stocks and holding them for growth is a long-term strategy. You are betting that the value of the stock will go up over time. As a young, beginner investor, stocks should be considered a long-term investment.



©Monkey Business Images, 2010/Used under license from Shutterstock.com

How can stocks help you meet your long-term needs?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Stocks and other securities are purchased through a stockbroker. *Stockbrokers* have accounts at stock exchanges and markets such as the New York Stock Exchange (NYSE) and the over-the-counter market (NASDAQ), which will be discussed in Chapter 12.

Stocks are considered risky, because an individual company could fail regardless of how large it is or how long it has been in business. There are many risks faced by businesses, from inflation risk to political risk. Stocks can be sold at any time as long as there is a buyer willing to purchase the stocks. However, if the stock price is low, the investor may want to hold the stock until the price rises to avoid a loss.

Common Stock

common stock stock that pays variable dividends and gives owners (stockholders) voting rights

Many companies have two types of stock: common stock and preferred stock. **Common stock** pays variable dividends and gives owners (stockholders) voting rights. Common stockholders can vote on issues such as who the company directors will be.

Common stockholders take a higher risk than preferred stockholders because common stock has no guaranteed dividends. If the company does well, the stockholder shares in the profit in the form of dividends. The directors of the corporation decide if a dividend will be paid as well as the amount of the dividend. There is no guarantee that the value of the stock will go up. Investors should review the selling prices of stocks they own often to see whether the prices are going up or down. If the price of a stock keeps going down over time, the investor may want to sell the stock and invest in another option.

Preferred Stock

preferred stock stock that guarantees a fixed dividend but does not provide voting rights

Preferred stock guarantees a fixed dividend but does not provide voting rights. Preferred stockholders are paid a set dividend regardless of how the company is doing. Because there is less risk, preferred stock generally costs more than common stock. If the company goes bankrupt, preferred stockholders would be paid before common stockholders.

FUTURES CONTRACTS AND COMMODITIES

futures contract an agreement to buy or sell a specific commodity or currency at a set price on a set date in the future

commodity an item that has the same value across the market with little or no difference in quality among producers

Futures contracts are another type of high-risk investment. A **futures contract** is an agreement to buy or sell a specific commodity or currency at a set price on a set date in the future. A **commodity** is an item that has the same value across the market with little or no difference in quality among producers. It could be soybeans, silver, live cattle, coffee, or other items.

Buying and selling a futures contract does not transfer ownership. It spells out the terms under which the commodity or currency will be bought or sold at a later date. Futures contracts are often used by sellers and buyers as a way to *hedge*, or reduce the likelihood of losing money in the future. For example, suppose a company has agreed to buy fuel in the future at a set price. The company might also want to buy some fuel futures contracts. If the price of the fuel rises, then the company may make enough money on the futures contracts to pay for the increased price of the fuel itself.

Investing in this category is very risky. You will have no control over what happens to prices for commodities. For example, the weather during the growing season may have a big effect on the price for products such as corn or orange juice. Investors who have an in-depth knowledge of how the

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...
DAY TRADERS

Day traders are individuals who attempt to make money by buying and selling stocks and bonds over short periods of time. These investments are not held for long-term growth. They are held just long enough to make a profit. When the day trader sees a stock's price rising, the stock is sold for a quick profit. When the day trader sees prices dropping for stocks that are good values, the trader buys. As soon as stock prices rise again, the trader makes a profit by selling. If the stock price does not rise again, the trader takes a loss.

Day traders must be aware of general market conditions. They also must be familiar with companies, products, and industries in which they trade. By carefully watching the market and keeping track of trends, day traders can make considerable profits over time. Of course, they are bound to make mistakes at times. They might sell before the stock hits its peak price or buy a stock that loses value. Because they trade so often, day traders must also consider trading fees and expenses when calculating actual profits.

Think Critically

1. When stock prices rise (bull markets), day traders make profits by selling stock. This activity causes the market to drop in value. Some people find this practice annoying at best and unethical at worst. How might it affect your overall portfolio?
2. Day traders must pay ordinary tax rates on their gains because they hold their stock for less than a year. Some have proposed those rates should be higher than regular tax rates. Why do you think this is so?

market for a particular product fluctuates may be able to do well trading commodities. For example, suppose a farmer has grown corn for 20 years. This farmer has studied the conditions that affect corn prices, such as the weather and the amount of corn already in storage from previous years. This farmer may have the knowledge needed to do well trading futures contracts for corn. However, the same farmer might know little about currency markets and might not do well trading currency. Investors in futures contracts should realize that they could make—or lose—a lot of money in a short time.

INVESTMENT CLUBS

An **investment club** is a group of people who pool their money together to buy and sell investments. The group may be small—just a few people who join together to buy an investment they could not afford as individuals. For example, three or four couples may jointly buy a *time share* or interest in a vacation home and share the time using it. The group may also consist of hundreds of people who do not know each other. Investment clubs may buy stocks, bonds, or other investments ranging from low risk to high risk. Clubs may take part in direct investing, as in buying stocks, or indirect investing, as in buying mutual funds. An investment club usually has stated goals and buys certain kinds of investments to reach those goals. The risk of the club is related to the knowledge, experience, risk strategy, and other characteristics of the club itself.

investment club a group of people who pool their money together to buy and sell investments

CHECKPOINT

Why is common stock more risky than preferred stock?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Do You Invest in Business Ownership?

There are several ways entrepreneurs can get involved in business ownership. If you own a business by yourself, it is known as a *proprietorship*. If you form a business with one or more other persons, it is called a *partnership*. These forms of small business ownership allow you to work for yourself. They are also considered risky because you will be responsible for any losses or for sharing any losses. In many cases, proprietors and partners commit their personal assets, cash, and lines of credit to get and keep the business going.

STARTING A BUSINESS

If you decide to go into business for yourself, you'll need a solid plan. More than half of all small businesses fail each year, often because of poor planning and inadequate funding. Starting a business is a very risky investment. If the business succeeds, however, it can be a profitable investment. As you learned in Chapter 2, you'll need a business plan. A business plan includes a statement of the company mission, the financing needs, the marketing plan, the management plan, and the operating plan for the company. The business plan attempts to show how the business will make a profit. It is used by potential lenders to evaluate your chances for success. Sample business plans can be found online by entering the keywords *business plans* in a search engine.

New businesses are started every year, some in garages or spare rooms. As they grow, they expand until they need a larger site, investors, and employees. The goal may be to go public through an *initial public offering (IPO)* so you can sell stock in the company to the general public. At this point, the business takes on a life of its own, and the founder becomes a stockholder.

BUYING A BUSINESS

Rather than starting your own business, you may wish to buy an existing business. You can purchase the business's assets, including inventory, store location, fixtures, and other items of value. An existing business may have established customers and a track record of success. But your initial costs will also be higher because you'll have to buy the business for its market value. A business that returns $50,000 or more to its owners every year in the form of profits may be worth several hundred thousand dollars on the market.

Which is less risky—starting a new business or buying an existing business? Why?

Some small business owners may choose to buy a franchise. A **franchise** is a contract that gives you the right to sell a company's products and

franchise a contract that gives you the right to sell a company's products and services

©simas2, 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

services. These businesses are less risky because the franchising company and its products may be well known and have a wide customer base. Many nationally known restaurant chains operate as franchises.

FORMING BUSINESS VENTURES

A *business venture* is a new business or business idea that is backed by investors who expect a return on their investment. Investors may join together to develop a new product idea or business strategy. They may patent a new product and bring it to market themselves, or they may sell it to another business to be developed further and marketed. Setting up a business venture for investment purposes can be risky, but it also provides investment opportunities that otherwise would not be affordable.

Some affluent individuals use their own money to help small businesses get started. These *angel investors* offer cash as well as their business experience and expertise. But in exchange, they often require some control of the business as well as a large ownership interest, such as 50 percent or more. When profits are made, they will be repaid for their loan.

Some people who decide to make a cash investment in a business venture while letting others operate the business are treated as *silent partners*. Silent partners share the profits as a return on the investment but are not liable for the business losses or liabilities.

CHECKPOINT ▸ ▸ ▸

What is included in a business plan?

What Are Other High-Risk Investment Choices?

Other investment choices include real estate, collectibles, precious metals, and gems. These choices are often considered *speculative*, or high-risk.

REAL ESTATE

Investing in real estate is an illiquid and often risky part of a balanced portfolio. The rewards can also be great when one of these investments gains substantial value over time.

Land or Vacant Lots

The purchase of unimproved land is often classified as speculative investing. The investor is buying now with the hope that the property will increase substantially in value in the long run (often decades away). For example, a vacant lot today may be in a sparsely populated area. But 20 or 30 years from now, it may be the prime location for a new shopping mall or housing subdivision. Buying now and holding for the future is a bet that value will rise. Because it is speculative in nature, most lenders will not provide financing (loans) for the purchase of unimproved land.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©1125089601, 2010/Used under license from Shutterstock.com

Why would you consider buying a vacant lot as an investment?

Some people also buy land with the hope that they will someday build a house on it. Many people expect that for retirement, they can develop the property or use it for recreation purposes.

Real Estate Investment Trusts

A *real estate investment trust (REIT)* is a corporation that pools the money of many individuals to invest in real estate. REITs are also known as real estate stocks. A REIT may own and operate income-producing property, such as an apartment building that rents to families or a factory building that rents to a business. A REIT may lend money to real estate developers. It may also invest in securities backed by real estate mortgages (investments in debt).

Buying shares in a REIT is a form of indirect investing, similar to buying shares in a mutual fund. You own shares of stock in the REIT. You do not own the individual pieces of property purchased by the REIT. Your money is invested indirectly in the real estate market. When REITs make profits, the profits are distributed to shareholders. Many REITS are publicly traded, and you can buy shares of them on the stock exchanges. Because of the nature of real estate, REITs fluctuate with market conditions. They often outperform many other investments over the long run.

Rental Property

Individuals can buy real estate beyond a family home. If you buy a house, duplex, apartment complex, vacation property, or other type of property and rent it to tenants, you will receive rental income. Buying rental real estate has risks and responsibilities. The tenant (renter) takes possession of a valuable piece of property and must take reasonable care of it. The owner is responsible for repairs and maintenance. This may mean fixing or replacing the roof, painting, and other upkeep. In addition to these expenses, other costs of ownership include any mortgage payment, property taxes, and other assessments. When the *rental income* exceeds your costs of ownership, you have a *positive cash flow*. When rental income does not exceed all of these costs, the result is a *negative cash flow*. Without enough cash to pay the costs, the owner must get cash from other sources. This situation is often referred to as "feeding the investment" because the investment (in this case, rental property) is unable to generate enough revenue to pay its own costs.

Rental property has many tax advantages. As the owner, you can deduct all the expenses of ownership, including property taxes. You can also deduct for *depreciation*, which is the decline in the value of the property due to normal wear and tear. Depreciation is really a "write-off" for tax purposes because your property will likely increase, not decrease, in overall value. Some day the mortgage on the rental property will be paid off, and the rent collected will be profit for the investor.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Real estate generally increases in value over time. Thus, an investment in rental property can provide both current income (cash flow) and long-term growth. However, the risks should be considered. Tenants may damage the property or fail to pay the rent. Vacancies can decrease rental income, cutting into your profits. Under poor economic conditions, the property may lose value, resulting in a loss when the property is sold.

COLLECTIBLES

Collectibles are rare, valuable objects, such as fine art, coins, decorative plates, books, and baseball cards. Investors buy these items expecting that they will increase in value over time. Some of these items do go up in value, but others do not. The investor must decide which items she or he thinks will increase in value. Coins are a commonly collected item. When coins are rare, they gain in value. Buying collectibles is a very risky investment choice. When collecting, have a clear goal in mind. Decide whether you are collecting items as an investment or whether you are simply buying items for your own enjoyment. If you are buying items as an investment, conduct market research to learn which items may increase in value. Also, learn how to distinguish between an authentic item and a replica. Being able to prove authenticity is very important.

collectibles rare, valuable objects, such as fine art, coins, decorative plates, books, and baseball cards

PRECIOUS METALS AND GEMS

Gold, silver, and platinum are examples of precious metals. **Precious metals** are rare metals, which are usually natural substances, that have known value around the world. The prices of precious metals can swing widely over time. These price swings make precious metal investments risky.

precious metals rare metals, which are usually natural substances, that have known value around the world

You can buy gold and silver as coins, medallions, jewelry, and bullion. Storage can be difficult due to bulk and weight. Instead of physically taking possession, you may wish to have ownership in the form of a certificate that indicates your ownership status and the storage location. You can also buy metals indirectly by investing in the stocks of companies that mine, store, or own them. Other metals in which you can invest include aluminum, tin, copper, lead, nickel, and zinc. Prices are found in the financial sections of newspapers and online.

Gems are natural, precious stones such as diamonds, rubies, sapphires, and emeralds. Prices are usually high and subject to change. Both gems and precious metals have their highest value in jewelry. However, buying jewelry at retail prices often involves very high markups, from 50 to 500 percent or more. Prices must increase substantially in the world market before you can recover the cost and make a profit from reselling jewelry. Owning gems is risky because the market for them is small and unpredictable. There may be no ready market (willing buyer) when you want to sell.

gems natural, precious stones such as diamonds, rubies, sapphires, and emeralds

CHECKPOINT

Why are real estate investments risky?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

11-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. An agreement to buy or sell a specific commodity or currency at a set price on a set date in the future

_____ 2. Rare, valuable objects such as fine art, decorative plates, coins, books, and baseball cards

_____ 3. Buying stocks and other investments directly from companies and holding them

_____ 4. A group of people who pool their money together to buy and sell investments

_____ 5. Stock that guarantees fixed dividends but does not provide voting rights

a. collectibles
b. commodity
c. common stock
d. direct investing
e. franchise
f. futures contract
g. gems
h. investment club
i. precious metals
j. preferred stock

_____ 6. A contract that gives you the right to sell a company's products or services

_____ 7. Natural, precious stones such as diamonds, rubies, sapphires, and emeralds

_____ 8. An item that has the same value across the market with little or no difference in quality among producers

_____ 9. Rare metals, which are usually natural substances, that have known value around the world

CHECK YOUR UNDERSTANDING

10. Describe two ways to make money from stocks.
11. Compare common stock with preferred stock.
12. Why are futures contracts often used as a "hedge" against losing money in the future?
13. Give three examples of commodities.
14. Why is it important to study the business plan when considering a business venture investment?
15. What risks are associated with owning rental property?
16. What are two ways in which an investor can make money on rental property?
17. How does a REIT work? Why is it safer than a direct investment in rental property?
18. Why are collectibles considered high-risk investments?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. Why would an investor prefer dividends to long-term growth?
20. Why are investments in stocks considered a long-term investment strategy?
21. Why do day traders engage in highly risky investing? How are they able to reduce risk?
22. How are investment clubs able to reduce risk for individual investors? Why would some investors consider this option?
23. Why is it risky to start a new business?
24. If you want to invest in some form of business ownership, what can you do to reduce your risk?
25. Why is real estate considered an illiquid investment? Why might this be a factor for some investors?
26. Why is the purchase of vacant land considered speculative, or highly risky?
27. Although investing in rental property can be risky, why do many people choose to do so?
28. Name some collectible items you have seen, collected, or read about that have increased substantially in value over the years. What would you like to collect?
29. Why are precious metals and gems considered risky investments? Why would investors be willing to take the risk?

EXTEND YOUR LEARNING

30. Suppose your investment portfolio is well balanced, with short-term investments, stocks, bonds, and mutual funds. You own your own home. Recently, you unexpectedly received a large sum of money. You want to take some risk and invest the money in hopes of making a high return.
    a. You are considering the high-risk investment options listed below. Which option would you choose?
        - Buy rental real estate
        - Pool your money with others in an investment club
        - Invest in a small business venture
        - Buy futures contracts for a commodity
        - Buy a large number of shares in one corporation
        - Buy a painting by a well-known, popular artist
        - Purchase a one-carat diamond ring in a white gold 14K setting
        - Buy a vacant lot in an area of town that is undeveloped

    b. Give an advantage and a disadvantage of your choice. Give reasons why you chose that option.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

COMPUTER TECHNOLOGY

Nearly all businesses rely on computer technology to conduct business and operate effectively. Information technology (IT) is a major component of how businesses reach customers, maintain accounts, and develop new products and services.

Systems designers and programmers must understand the nature of the business and how the software and hardware work together to meet those needs. They create specialized systems that must be tested and maintained, debugged, and updated over time.

Computers provide the basic tools for communications for most companies. Most systems involve extensive networking that connects computers together within a company and with its vendors, customers, and affiliates across the country.

Employment Outlook

- Employment growth is expected to be much faster than average for all occupations in this field, with an expected 20 percent growth through 2018.

Job Titles

- Systems analyst
- Computer programmer
- Systems engineer
- Quality assurance analyst
- Software engineer
- Systems designer
- Network support staff

Needed Education/Skills

- A bachelor's degree in computer science is desired; an advanced degree is preferred.
- Expertise in some field, such as finance, health management, marketing, or other specialty, is important.

What's it like to work in . . . Computer Technology

Jayce works as a consultant for a firm that customizes information processing systems. She works three days a week in the office or in the field and telecommutes the other two days. She often works more than 50 hours a week, including travel time to different client locations. Because of her unique problem-solving skills, she works mostly with clients who need an assessment of their current and future needs and a redesign of their systems.

Today Jayce is testing a new program she designed for a major client. As a senior analyst, Jayce is responsible for making sure all the parts of the system work together so her clients can access data in an efficient manner when needed.

Jayce often works alone with the computer for many hours a day. She also works with her staff and with clients, communicating needs and proposed solutions.

What About You?

Do you enjoy working with computer systems, looking for ways to fix errors or to make them work better? Could you work with technical equipment as well as with colleagues and clients? Would a job in computer technology appeal to you?

©Andresr 2010/Used under license from Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 11 Assessment

SUMMARY

11-1 Low-risk and liquid saving options include savings accounts, money market accounts, and brokerage accounts. The interest rates on these options are usually low.

Certificates of deposit and life insurance savings plans are low-risk saving options that provide a slightly higher return, but they are not liquid. Withdrawal penalties may apply if you withdraw money before a set time period. However, you may borrow against the money in these accounts.

Low-risk investment options include U.S. savings bonds, municipal bonds, investment-grade corporate bonds, and annuities purchased from an insurance agency.

Government bonds provide tax advantages. Some corporate bonds can be called early (callable bonds) or exchanged for shares of stock (convertible bonds).

11-2 Mutual funds are a form of indirect investing with medium risk. You can choose the types of funds that best match your investing goals and risk comfort level.

Buying a home has risks, but it provides tax advantages and can provide a good return when home values rise faster than inflation.

Individual retirement account options include IRAs, SEPs, and Keoghs. Some of these plans are tax shelters because they lower tax liability.

Employer-sponsored retirement accounts include defined-contribution plans, such as 401(k) and 403(b) plans, and defined-benefit plans, such as pension plans. These are often part of an employee's benefit package.

When you are vested, you can take your retirement account with you when you leave a job. Rollover is the process of moving an investment balance to another qualified account, such as an IRA account.

11-3 Direct investing involves buying stocks and other investments directly from a company. Common stock is more risky than preferred stock. Futures contracts for commodities are considered speculative because they carry a very high risk.

Starting or buying a business or forming a business venture with other investors are ways to invest in business ownership.

Other high-risk investment choices include buying unimproved land, shares in a real estate investment trust (REIT), rental property, collectibles, precious metals, and gems.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Answer the following questions:
   a. You have a CD for $1,000. The interest rate is 5 percent annually, and the term is 5 years. The CD has an early withdrawal penalty. If the money is withdrawn before 36 months, no interest is paid and a penalty of 6 months' interest is assessed. If you withdraw the money after 12 months, what penalty will you pay? How much money will you get?
   b. You have a CD for $1,000. The interest rate is 5 percent annually, and the term is 5 years. The CD has an early withdrawal penalty. If the money is withdrawn before 36 months, interest is paid for the time the money is in the account, but a 6-month interest penalty is deducted. If you withdraw the money after 12 months, what penalty will you pay? How much money will you get?
   c. You purchased a house for $125,000. You spent $15,000 for repairs, remodeling, property taxes, and other expenses. You sold the house one year later for $160,000. How much profit did you make on the house? What is your return on investment?
   d. You purchased 100 shares of stock at $125 per share. One year later, the price of the stock has risen to $150 per share. What is the percentage increase in the stock price?
   e. You purchased a five-year corporate bond with a face value of $7,500 at a discount rate of 5 percent. The annual coupon rate is 4.5 percent. Upon maturity, you redeem the bond. What is the purchase price of the bond? How much interest did you earn while holding the bond? What is your return on investment?

Teamwork

Point Your Browser

www.cengage.com/school/pfinance/pfl

2. **Research** Work with a classmate to complete this activity.
   a. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 11. From the data files, open the Word file *CH11 Grid*. This file contains the following grid:

	Low Risk	Medium Risk	High Risk
Liquid			
Low Return			
Medium Return			
High Return			

   b. Complete the grid of investments based on risk, return, and liquidity. In each square of the grid, write one or more investments that fit the criteria. For example, in the first square, write the name of a savings or investing option that is liquid and has low risk. Write *None* in a square if no investment meets both the criteria.
   c. Pick one type of investment from each column (one with low risk, one with medium risk, and one with high risk) that you would consider having in your portfolio. Give an advantage and a disadvantage of each one.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

3. **Ethics** Many companies have stopped offering pension plans. Some companies that still provide the plans have not funded them at the needed level. Other companies have changed the rules that govern their pension plans to reduce benefits. A company might also declare bankruptcy. These actions often leave employees without some of their promised retirement benefits. The Pension Benefit Guaranty Corporation (PBGC) is a federal corporation created by the Employee Retirement Income Security Act of 1974. Its mission is to protect retirement incomes of millions of American workers with pension plans. When a pension plan fails, workers may receive some benefits from the PBGC. Although the employer's actions may not be illegal, some people think it is unethical to deny retired workers the benefits they were promised. What effect has this type of activity had on American workers and their families? What message does this convey about the importance of retirement planning?
4. **Economics** When you buy U.S. savings bonds, notes, and bills, you are lending money to the U.S. government. As such, it is part of the national debt. Research the national debt online and prepare a two-page report on what it is, how much it is, what types of debt are involved, and what it means to you as a current or future taxpayer.

Take Action

RESEARCH MUTUAL FUNDS

Indirect investing is a good way to have a diversified portfolio and to reduce risk. Buying mutual funds is a common form of indirect investing.

a. Use the Internet to find sites about mutual funds. Use a search engine and enter the keywords *mutual fund list*. You could also enter other words in the search engine, such as *bonds*, *growth*, or *stocks*, to find a particular type of mutual fund.

b. Review two or three websites that tell about mutual funds. Choose one fund. For that fund, record the following information:
   - Fund name
   - Fund trading symbol
   - Strategy or objective of the fund (such as balance or growth)
   - Holdings (list of investments the fund contains)
   - Performance in recent years (percent of return each year)

c. Find the selling price of a share in the mutual fund. You may have to visit a different website that provides market quotes to find the price. The price will likely be labeled NAV (for net asset value). The NAV is the price of one share in the fund at the close of trading on a particular day.

d. What do you think is the risk level of this mutual fund—low, medium, or high? Prepare a report describing your findings and making a recommendation for the purchase/rejection of this mutual fund.

Include the information you collected about mutual funds in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

CHAPTER

12 Buying and Selling Investments

©Monkey Business Images, 2010/Shutterstock.com

12-1 Researching Investments and Markets

12-2 Buying and Selling Securities

12-3 Regulatory Agencies and Laws

Chapter 12 covers the basics of buying and selling investments. You will learn about doing research before you invest to help you make better choices. Much information about investing is available. Some information is free; some is very costly. Trading securities takes place in primary and secondary markets. You can hire a full-service broker or you can take a more active role in selection of and maintenance of your investment portfolio. Either way, there are effective strategies for purchasing that will save you both time and money. You will also learn about many regulatory agencies that regulate and supervise the financial services industry. They are designed to inform and protect you, the investor, when you buy and sell securities. New financial reform legislation is designed to enhance consumer protections.

ONLINE RESOURCES

Personal Financial Literacy Website:
www.cengage.com/school/pfinance/pfl

Data Files
Key Terms Flashcards
Flash Games
Chapter 12 Supplemental Activity
Web Links

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-1 Researching Investments and Markets

GOALS

- Describe the types of financial information found in magazines, newspapers, newsletters, and other public sources.
- Discuss the kinds of advice and assistance that are available from financial experts.
- Explain how financial markets are designed for securities transactions.

KEY TERMS

- annual report, p. 378
- full-service broker, p. 381
- discount broker, p. 381
- primary market, p. 384
- secondary market, p. 384
- securities exchange, p. 384
- auction market, p. 384
- over-the-counter (OTC) market, p. 384
- stock dividend, p. 385
- stock split, p. 386

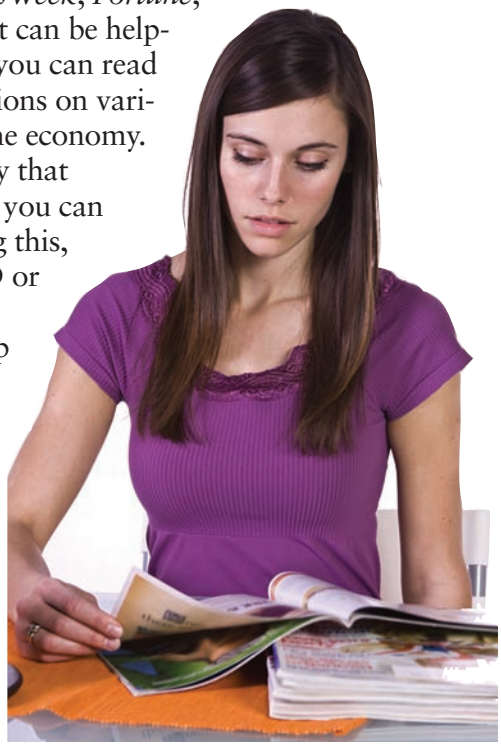
What Are Sources of Investing Information?

Some people hire a stockbroker or financial planner to help them choose investments. Other people do research and make choices on their own. Either way, investors need a basic knowledge of financial markets. Keeping informed about current market conditions helps investors make better choices. There are several sources that provide investing information.

MAGAZINES

Business magazines, such as *BusinessWeek*, *Fortune*, and *Forbes*, contain information that can be helpful to investors. In these magazines, you can read business articles and get expert opinions on various topics related to investing and the economy. For example, suppose the experts say that the economy is growing. As a result, you can expect interest rates to rise. Knowing this, you may want to avoid buying a CD or bond with a low, fixed interest rate. Reading business magazines can help you understand the economy and the markets. This, in turn, will help you choose the right investments at the right times.

You can also find good information in news magazines such as *Time*, *Newsweek*, and *U.S. News & World Report*. Read these magazines to study world events that affect the economy and investments. The magazines also have regular features that include financial advice.



Where can you find current information about businesses in which you might wish to invest?

©Mehmet Dilsiz, 2010/Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Several magazines give information about saving, investing, and personal finance. Examples include *Money*, *Consumer Reports*, and *SmartMoney*. You can read articles in these magazines about people who have been successful. The articles can help you learn from their mistakes and profit from their successful strategies.

NEWSPAPERS

One of the best sources for current information is the financial sections of newspapers. You will find articles about business triumphs and failures. You can read about new products and services. You will also see articles about the latest business scandals and frauds. Price quotes for securities are provided in many newspapers. *Securities* include stocks, bonds, mutual funds, and other investments. The information you learn can help you make better investment choices.

The *Wall Street Journal* and *Barron's* are two national newspapers that report financial news and other events that affect markets. They provide market price quotes and articles about national and world events. These articles discuss market data and predict how the data will affect the stock market. For example, when the Fed raises interest rates, different parts of the market are affected in different ways. (The credit industry will benefit, and stock prices will rise.) These newspapers are geared to the business world, but consumers can benefit from reading them as well.

INVESTOR NEWSLETTERS

Many financial advisers prepare free newsletters for their clients. The newsletters contain data about economic events and trends. The advisers may also make comments about certain stocks, bonds, or mutual funds. They may recommend that investors buy or sell securities. This information can help investors decide how to manage their portfolios.

Investors can subscribe to newsletters that give financial advice. Examples include *Standard & Poor's Stock Reports*, *Moody's Investors Service*, and *Value Line Investment Survey*. The newsletters may discuss risk reduction strategies, changing market conditions, stocks to watch, and other investing information. Subscription costs for newsletters vary.

COMPANY REPORTS

annual report a company's report to shareholders about the financial position of the company

All companies that sell stock to the public must publish yearly annual reports. An **annual report** is a company's report to shareholders about the financial position of the company. It tells about profits or losses and plans for the future. It also provides information about the company stock and dividends. Annual reports include information that investors can use to compare one company to another. You can see how each company is doing over time. If you are considering investing in a company, learn as much as you can about that company. Annual reports are free, and many are available online as well as in print.

THE PROSPECTUS

By law, investment companies must provide detailed information about their mutual funds. A mutual fund company must provide a prospectus for each fund offered. The *prospectus* is a legal document that offers securities

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

or mutual fund shares for sale and includes a detailed description of the securities. It must contain the terms, a summary of the fund's portfolio of investments, its objectives, and financial statements showing past performance. You can usually find this information on the investment company's website as well. Before choosing a mutual fund, read the prospectus carefully. Compare the fund's objectives with your own, and compare its past performance with that of other funds you are considering.

THE INTERNET

Investors can find information about companies, products, and market trends on the Internet. One of the best ways to find information is to use a search engine. Google, Yahoo!, Bing™, and other search engines allow users to search for data on almost any topic. Users can find out about companies, stocks, bonds, mutual funds, brokerage firms, and banks. Many businesses provide company data on their websites. You can find a company website by entering its name in a search engine. Figure 12-1.1 lists some Internet sites that investors might find helpful. Some sites allow investors to set up a free account and monitor investments.

USING RESEARCH DATA

A great deal of information about investing is available in print and online. Investors need to know about the economy and current market trends. They also need to learn about specific companies or funds in which they may want to invest. News articles are a good source of information on the economy and markets. Annual reports and online profiles are good sources of data about specific companies or mutual funds.

Websites such as Yahoo! Finance allow the user to enter a company symbol to find data about the company. The current stock price for the company is given. News articles related to the company or industry may also appear. A history of stock prices, stock splits, and dividend data is

Figure 12-1.1 Internet Sites with Investor Information

Site Name	Information/Features Provided
Bloomberg www.bloomberg.com	News articles; market data for stocks, bonds, currency, mutual funds, commodities, and other securities; investment tools; online tutorials for investing; and other features.
CNNMoney.com money.cnn.com	Current financial news and information to help investors make better decisions.
Kiplinger www.kiplinger.com	Tools to help beginners get started. Investors can use this site to track investments in both stocks and mutual funds.
Morningstar www.morningstar.com	Articles related to investments and stocks in the news, research reports, newsletters, and portfolio tracking and other tools.
Reuters www.reuters.com	Business and investing articles, stock quotes, bond and currency news, and investment tracking tools.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 12-1.2 Key Figures Used in Comparing Firms

Figure	Description
Current stock price	The amount investors are willing to pay for a share of ownership in the company.
Number of employees	Increases or decreases in the number of employees can reflect growth or downsizing.
Market cap (capitalization)	The total value of a company in the stock market (total shares outstanding times price per share). This figure, along with revenue, indicates the size of a company.
Revenue	The amount of money received from business activities. This may be mostly from sales of products and/or services to customers.
Net income or profit	The amount of money earned after deducting all the business's expenses. To investors, this number is more important than revenue.
Profit margin	Profit shown as a percentage. It is the net income divided by revenue for the same period.
P/E ratio	The price-earnings ratio compares the selling price of a company's common stock to the annual profits (earnings) per share. Fast-growing or high-risk companies may have higher P/E ratios than slow-growing or low-risk companies. This ratio is an important measure of a stock's value.
Current ratio	A measure of a company's ability to pay its current debts from current assets. It indicates a company's liquidity and financial strength. The current ratio is calculated by dividing the total current asets by the total current liabilities.

available. Key numbers and financial statements are provided. Much of the same data can be found in company annual reports. Data are also available for mutual funds. All these data can help investors evaluate the company or mutual fund.

With so much data available, investors may feel overwhelmed. They may not understand all the data or know how to compare companies or funds. Figure 12-1.2 describes a few key figures that investors can use to compare companies. Investors who plan to choose stocks or mutual funds on their own may want to take classes or read books to learn more about investing. Many investors seek advice from experts when deciding how to invest.

CHECKPOINT ▸ ▸ ▸

What types of financial information can be found in print sources?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

What Professional Advice Is Available?

Choosing which stock, bond, mutual fund, or other investment to buy is an important decision. Many investors seek advice from experts in the investing field. A fee is typically charged for investment advice or for making a sale or purchase for an investor.

STOCKBROKERS

A *stockbroker* is a licensed professional who buys and sells securities on behalf of others. Stockbrokers may also provide advice on which products to buy. The broker will make commissions on the items the investor buys. Stocks, bonds, mutual funds, and commodity futures contracts are examples of securities traded through stockbrokers.

Full-Service Brokers

A **full-service broker** is a qualified stockbroker who provides advice about what securities to buy and sell. Your broker will consider your investment goals and risk tolerance levels. Be honest about your risk tolerance and have realistic expectations about the returns you can earn on the money you invest. The information you provide, along with the broker's knowledge about the market and securities, will be used to select stocks or other investments to help you reach your goals. The broker will recommend the best timing for stock trades and will carry out the transactions for you. You will be charged a commission and/or fee for the broker's services. You will receive regular reports of activity and account balances. Merrill Lynch and Edward Jones are examples of full-service brokerage firms.

©Stephen Coburn, 2010/Shutterstock.com

What are the advantages of using a full-service broker?

full-service broker a qualified stockbroker who provides advice about what securities to buy and sell

Discount Brokers

A **discount broker** is a qualified stockbroker who buys and sells securities at a reduced commission but offers no advice. The term *broker* may refer to an individual person who works for a brokerage firm or to the firm itself. The fees or commissions charged by a discount broker are much lower than those charged by a full-service broker. The firm may charge a flat fee for its services of buying and selling. Discount brokers offer limited services. They do not give advice or help manage assets. However, some discount firms do offer free research reports. A discount

discount broker a qualified stockbroker who buys and sells securities at a reduced commission but offers no advice

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Focus On...

FULL-SERVICE OR DISCOUNT BROKERS?

There is a healthy competition between full-service brokers and other types of brokers. A smaller fee for services is one reason people choose discount or online brokers. There are other factors to consider as well. One factor is the amount of information available and how much it costs. If you have to pay extra to get the information you need to make good choices, then discount brokers may not save you money in the long run.

Another factor to think about is the amount of help you will need to make wise investment choices. If you do not have the time or expertise to study the market, you may find that your investment choices are not very profitable. You may be better off paying higher fees for sound investment advice from a full-service broker.

Investors should also look at how easy it is to buy and sell. Investors must compare services in terms of the type of trading they want to do. For example, do you want to trade online or by phone? Where is the nearest brokerage office? How often do investors receive statements? What is the charge for services such as research? What are the fees that will be charged for opening an account? Are there minimum deposits? Consider all these factors carefully to help decide which type of broker is right for you.

Think Critically

1. For your initial step into investing, would you use a full-service broker or a discount broker? Why?
2. When you become a seasoned investor, after many years of successful investing, which would you be more likely to use—a full-service broker or a discount broker? Why?

broker has the same qualifications as a full-service broker. Fidelity Investments and E*TRADE are examples of discount brokerage companies.

Online Brokers

Many brokerage firms offer their services online. Online brokers charge low fees. They also provide the least amount of service. They do not provide investment advice or manage assets. Some online firms do offer free research reports. You must make your own decisions about buying and selling. Once you decide, you set up an account with the online broker. Different types of accounts are available. Investors can make single trades. Some sites also offer automatic investment plans that help users invest on a regular basis. ShareBuilder and TD Ameritrade are examples of online brokers.

FINANCIAL PLANNERS

A *financial planner* is an adviser who helps people make investment decisions to meet stated goals. Financial planners work for investment and brokerage firms and at financial institutions. Typically, investors are asked to provide data about assets owned and income earned. They also list their goals, such as saving for retirement or paying for a child's college education. The planner considers this information and suggests options that will help meet the investor's goals. Some financial planners also sell securities, such as stocks and bonds. They may make a commission on financial products they sell.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

©EdBockStock, 2010/Shutterstock.com

What are the advantages of working with a certified financial planner?

A *certified financial planner* (CFP) has taken coursework and has passed an exam, indicating an expertise in developing financial plans for individuals. These planners often own their own companies, meet with clients, discuss their full financial picture, give advice, and choose investments for clients.

FINANCIAL INSTITUTIONS

Investors may go to some banks and credit unions for financial advice. Employees at these companies are licensed to sell securities that are endorsed by the company. These *licensed personal bankers* make a commission on products they sell. Some banks offer their own brand of securities. Rather than investing directly, investors can choose the bank's investment account. This is similar to owning shares of a mutual fund.

GETTING THE BEST ADVICE

Choose advisers that you can trust to help you make the right choices. Be sure that they have proper licenses, bonds, and certifications. Ask how long they have been working for their bank or investment company. Also ask if they are members of FINRA (Financial Industry Regulatory Authority). The FINRA website provides a "BrokerCheck" feature, which enables you to learn about the background and license status of investment firms and brokers. Many state governments also provide similar data. When choosing a broker or financial planner, ask how your confidential and personal data will be protected. Work only with advisers and firms that you think are properly licensed and qualified and have your best interests in mind.

CHECKPOINT

How does a discount broker differ from a full-service broker?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

How Are Financial Markets Designed?

When securities are bought or sold on the financial market, they are said to be traded. Securities can be traded in the primary market or secondary market.

primary market the financial market in which new issues of securities are sold

The **primary market** is the financial market in which new issues of securities are sold. The proceeds from sales go to the issuer of the securities sold. New security issues (stocks and bonds) are offered through investment banks. An investment bank is a company that helps corporations raise money by selling stocks and bonds for them. A fee is charged for this service. The process takes many months to complete. New security issues are often in the form of initial public offerings. An *initial public offering* (IPO) is a company's first sale of its stock to the public. IPOs are often made by small or young companies seeking to expand their business. They can do this with the money raised by selling stock. Visa, Inc., the world's largest credit card network, currently holds the record for the largest IPO after it raised nearly $18 billion in its market debut in 2008.

secondary market the financial market in which previously issued securities are bought and sold

The **secondary market** is the financial market in which previously issued securities are bought and sold. The buyer is trading with an investor who already owns the stock. After stock is sold in the primary market, it can be resold many times in the secondary market.

Investors can use the services of a broker to trade securities. Securities may be listed on securities exchanges or in the over-the-counter market. Investors can also trade securities directly.

SECURITIES EXCHANGES

securities exchange a place where brokers buy and sell securities for their clients

Many securities are listed on securities exchanges. A **securities exchange** is a place where brokers buy and sell securities for their clients. Securities listed on the exchange have been accepted for trading at that exchange. The New York Stock Exchange (NYSE) is one of the largest security exchanges in the world. It lists more than 8,000 stocks. To have stock listed with the NYSE, a company must meet minimum requirements pertaining to the number of shares of stock outstanding, income and revenue amounts, and market value. The exchange's stockbroker members can buy and sell securities. The American Stock Exchange (AMEX) and various regional stock exchanges are smaller. They have less strict listing requirements for companies than does the NYSE. Securities exchanges are auction markets. In an **auction market**, a stock is sold to the highest bidder. Both buyers and sellers compete with others for the best price.

auction market a market in which a stock is sold to the highest bidder

OVER-THE-COUNTER MARKET

over-the-counter (OTC) market a network of dealers and brokers who buy and sell stocks and other securities that are not listed with a securities exchange

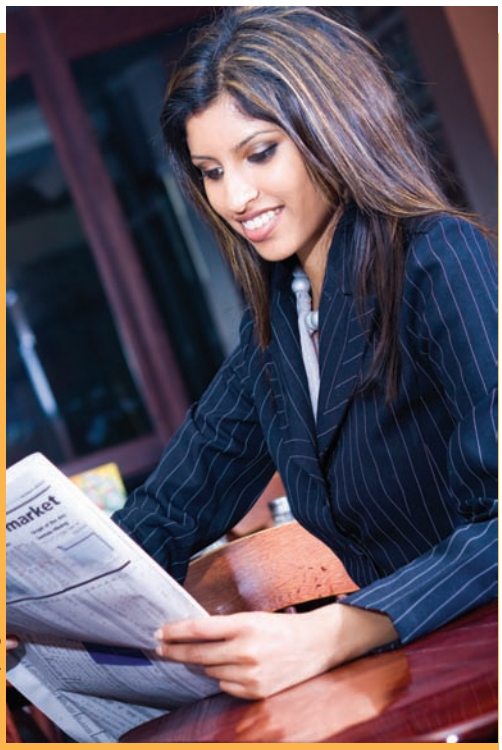
Securities can also be found in the over-the-counter market. The **over-the-counter (OTC) market** is a network of dealers and brokers who buy and sell stocks and other securities that are not listed with a securities exchange. There are generally no listing requirements for stocks sold on the OTC market. Stocks issued by several thousand companies are traded this way. NASDAQ is an electronic marketplace for over-the-counter stocks. This computerized system allows investors to buy and sell stocks through their brokers. When stock is traded, offers to buy

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

are matched with offers to sell. NASDAQ has more trading volume than any other stock exchange in the world.

DIRECT INVESTING

Direct investing involves buying securities directly from a corporation. You do not use a broker. There are many forms of direct investing. Buying U.S. government savings bonds is a form of direct investing that carries low risk. Many companies have direct investing plans that allow individual investors to purchase stock. Some companies (such as banks or utilities) limit individual stock purchases to customers or residents, and there may be a minimum purchase requirement. At other companies, employees can buy shares of stock in the company or receive shares of stock as part of a benefits package. There are no brokerage fees or other costs for the employee. These are also forms of direct investing. Direct investing can be risky if you buy stock in only one company because your investment is not diversified. However, you can use direct investing to buy stocks in several companies.



©michaeljung, 2010/Shutterstock.com

Why do some investors choose direct investing instead of using brokers?

Direct investing offers many advantages, such as the avoidance of taxes in some cases. If cash dividends are converted to new shares of stock, they are not taxed. Interest on U.S. savings bonds is not taxable until the bond is cashed. When used for education expenses, some bonds are not subject to federal taxes at all. Direct investing also allows you to avoid brokerage fees. Another advantage is that you are aware of the investments you have at all times. When you buy direct, you make the decisions about the items to buy and sell and the timing of the trades. People who participate in direct investing can use a spreadsheet to keep track of their investments, as shown in Figure 12-1.3.

REINVESTING

When investors forego a cash dividend to receive more shares of stock in a company, this is a form of *reinvesting*. By acquiring more shares of stock, stockholders have the opportunity to grow their wealth. Many corporations issue a stock dividend instead of a cash dividend. A **stock dividend** is a dividend paid in the form of new shares of stock. For example, with a 10 percent stock dividend, you would receive 10 new shares of stock for every 100 shares of stock you currently own. The price per share does not change. Having more shares of stock grows

stock dividend a dividend paid in the form of new shares of stock

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 12-1.3 Direct Investing Record

	A	B	C	D	E	F	G
1	STOCK RECORD						
2	Stock A:						
3	Purchase Date	No. of Shares	Price Paid per Share	Sold Date	No. of Shares	Price Rec'd per Share	ROI
4	12/2/20--	500	$55.25				
5	3/30/20--	100	$58.45	12/28/20--	100	$68.00	21.9%
6							
7	Date		Closing Price			Average Price Paid:	$55.78
8	1/30/20--		$55.00				
9	2/1/20--		$57.25				
10	3/1/20--		$58.95				
11	4/1/20--		$52.50				
12	5/1/20--		$53.78				
13	6/1/20--		$57.50				
14	7/1/20--		$59.32				
15	8/1/20--		$59.25				
16	9/1/20--		$60.35				
17	10/1/20--		$65.50				
18	11/1/20--		$70.65				
19	12/1/20--		$68.50				
20							
21	Average Price:		$59.88				
22	Highest Price:		$70.65				
23	Lowest Price:		$52.50				

wealth. In the future, you will receive more dividends and have more shares of stock to sell.

stock split the issuance of more stock to current shareholders in some proportion to the stock they already own

Reinvesting may also take the form of a stock split. A **stock split** occurs when a company issues more stock to current shareholders in some proportion to the stock they already own. A two-for-one split means that for every share you own, you get an additional share of stock. For example, assume you own 100 shares of stock at $50 par value per share. (*Par value* is the stated value of the stock at the time it is issued.) After a 2:1 split, you would own 200 shares with $25 par value per share. In other words, the number of shares increases by the same multiple that par value decreases. While your total stock value is still $5,000, now you have more shares. As stock prices rise, your total value is set to rise as well. Stock splits are used by corporations to keep their share prices low enough for large numbers of individual investors to buy their stock.

Stock dividends and stock splits involve no brokerage fees or costs to investors, and they are not taxable income. Many corporations choose these forms of rewarding investors (rather than paying cash dividends) to preserve their cash and use it for growth purposes.

CHECKPOINT

How is the primary market different from the secondary market?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-1 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. A qualified stockbroker who provides advice about what securities to buy and sell

____ 2. A qualified stockbroker who buys and sells securities at a reduced commission but offers no advice

____ 3. A financial market in which a stock is sold to the highest bidder

____ 4. The financial market in which previously issued securities are bought and sold

____ 5. A dividend paid in the form of new shares of stock

____ 6. The financial market in which new issues of securities are sold

____ 7. A network of dealers and brokers who buy and sell stocks and other securities that are not listed with a securities exchange

____ 8. A company's report to shareholders about the financial position of the company

____ 9. The issuance of more stock to current shareholders in proportion to the stock they already own

a. annual report
b. auction market
c. discount broker
d. full-service broker
e. over-the-counter (OTC) market
f. primary market
g. secondary market
h. securities exchange
i. stock dividend
j. stock split

CHECK YOUR UNDERSTANDING

10. List three magazines and/or newspapers that give information and advice about spending and investing.
11. Describe the type of information available in a company annual report.
12. How do investment professionals, such as stockbrokers or financial planners, help investors?
13. What is an IPO? What is its purpose?
14. How many times may a stock be sold in the primary market? In the secondary market?
15. Give an example of an auction market. Give an example of an over-the-counter (OTC) market.
16. What are some advantages of direct investing?
17. How are stock dividends different from stock splits?
18. What is meant by reinvesting?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

19. Why might an investor want to subscribe to an investor newsletter?
20. Why would someone buy stock on a securities exchange rather than in the over-the-counter market?
21. Why would you use the Internet to find information on investing? What kinds of information might you research online?
22. Why would you invest directly with a company? Why would you reinvest?
23. Why is it important to research advisers before investing with them? What types of information would you want to know?
24. How do investors benefit from stock splits?
25. Why would a company choose to reward investors with a stock dividend rather than a cash dividend?

EXTEND YOUR LEARNING

26. Choose three corporations to research online. Create a table that compares the three companies, using the format shown below. Enter the names of the companies in the top row and then complete the rest of the table.

Company name			
Industry or primary business			
Current stock price			
Revenue			
Net income			
Profit margin			
P/E ratio			
Current ratio			

a. Which company had the highest revenue?
b. Which company had the highest net income?
c. Which company had the highest P/E ratio?
d. Did each company have a current ratio of 1 or above? If not, which ones did not?
e. Have you heard or read any current news reports about these companies or their industries? If so, what were the main points of the reports?
f. Would you consider one or more of these companies a good investment? Why or why not?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-2 Buying and Selling Securities

GOALS

- Explain how to set up a brokerage account and begin the process of buying and selling.
- Describe techniques to use when buying and selling securities.

KEY TERMS

- market order, p. 390
- limit order, p. 390
- stop order, p. 390
- discretionary order, p. 390
- selling short, p. 391
- buying on margin, p. 392
- buy and hold, p. 392
- stock turning, p. 393
- round lot, p. 393
- odd lot, p. 393

How Are Stocks Bought and Sold?

The purchase and sale of securities in the financial markets is a simple process. It begins with setting up an investment account.

SET UP AN ACCOUNT

To get started buying and selling securities, begin by choosing your venue. Set up an account at a full-service broker, a discount broker, or at your bank or other financial institution. This will allow for the transfer of money that goes along with the buying and selling of securities.

Setting up an account is as simple as opening a new savings or checking account. You must provide identification information such as your social security number. The account will house your transactions, and you will receive monthly or quarterly statements. Most of these brokerage accounts can be accessed online with a user name and password.

When you access your account online, you can see daily changes in value. Most brokerage accounts require a minimum deposit or a regular monthly deposit amount. You will be in charge of managing your account. If you would like to make changes in your asset allocations or types of investments, you will need to follow specific procedures for requesting those changes.

How can you set up a brokerage account?

©Andresr, 2010/Shutterstock.com

PLACE TRANSACTIONS

Once you have decided to buy or sell a stock, there are four types of transactions, called *orders*, that you can request.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Market Order

market order a request to buy (or sell) a stock at the current market price

A **market order** is a request to buy (or sell) a stock at the current market price. In an auction market, the broker will try to get you the best price as soon as possible. There is no guarantee of what you will pay (or receive). Stock is auctioned to the highest bidder, so you may or may not get the price you hoped. For example, you may have $1,000 in your brokerage account and make a request to buy as many shares of XYZ stock as can be purchased for that amount. At the end of the day, you may have purchased 20 shares at the current market price of $50 per share.

Limit Order

limit order a request to buy (or sell) a stock at a specific price

A **limit order** is a request to buy (or sell) a stock at a specific price. When you are buying, a limit order ensures that you will not pay more than a set dollar amount. When you are selling, the order ensures that you will not get less than a specific dollar amount if the stock is sold. For example, you may tell your broker to buy stock when it drops to $40 per share. If the price does not go that low, the purchase will not be made. The broker will wait until the price hits $40 and then buy the shares of stock.

Stop Order

stop order a request to sell a stock when it reaches a certain price

A **stop order** is a request to sell a stock when it reaches a certain price. This type of order protects you from a sudden drop in price. It also allows you to capture profits when a higher price is reached. For example, you may own 100 shares of ABC stock. You purchased them for $25 a share, and currently the price is $27 (down from a high of $33). You are not confident in this stock because it is losing value, so you ask your broker to sell your shares if and when they reach $25 a share. Thus, if the market price drops to $25, your broker will sell your stock at that price.

Discretionary Order

discretionary order an order to buy (or sell) a stock that allows the broker to get the best possible price

A **discretionary order** is an order to buy (or sell) a stock that allows the broker to get the best possible price. The broker also determines the best time to make the transaction. Discretionary orders give the broker the power to use her or his experience and judgment to make good decisions. For example, you may place $1,000 into your account and ask your broker to buy shares of JKL stock as soon as they reach their best price. Your broker would research that stock and see what is likely to be the best price and the best time to purchase it.

TAKE ACTION

Following the investor's decision to move forward with a transaction, the broker then takes action. Figure 12-2.1 illustrates the steps that take place when you contact your broker to complete a purchase of stock in an auction market.

CHECKPOINT ▸ ▸ ▸

What is the process for buying and selling securities?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Figure 12-2.1 Steps in a Stock Buying Transaction

To buy stock traded on the New York Stock Exchange, an investor would take the steps described below.

1. The investor contacts the broker and asks him or her to buy shares of stock.
2. The broker relays the order electronically to a clerk at the stock exchange.
3. The clerk for the broker gives the message to a floor broker.
4. The floor broker goes to the trading post at which this stock is traded.
5. The floor broker negotiates a buy from the floor broker for the stock being sold.
6. After the trade is made, the floor broker relays a message to the clerk and to the consolidated ticker tape (a digital display that shows securities transactions).
7. The sale appears on the ticker tape.
8. A confirmation is sent to the investor's broker.
9. The broker notifies the investor that the transaction is complete.
10. The investor's account reflects money exchanged for stock at the price and quantity agreed upon.

How Do You Know When to Buy or Sell?

When you buy securities, you are committing to a long-term investment. Unlike your 401(k), annuity, or mutual fund, which are managed by professionals, personal investing requires you to make your own choices. As an investor, you will need to develop a strategy for buying and selling stocks.

USING CASH

By setting aside cash for investing, you will be ready to buy and sell stock or other securities when you feel it is a good time to do so. In Chapter 10, you learned about *market timing* and *investment tracking* strategies to help you decide when it is time to buy or sell. You can use your brokerage account to make stock trades when the time is right.

USING CREDIT

If you do not have enough cash to make the type of purchase you want, there are still ways you can *leverage* it. In other words, you can borrow money to complete the trade.

Selling Short

Selling short is selling stock that has been "borrowed" from a broker and replacing it at a later date. You are hoping to buy back the stock at a lower price than you sold it for, thus making a profit. This is a lawful thing to do (if the brokerage firm allows it), but it is highly risky. You are betting that stock prices will drop. If prices for the stock rise, you will lose money.

selling short selling stock that has been borrowed from a broker and replacing it at a later date

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Buying on Margin

buying on margin borrowing money from your broker to buy stock

Buying on margin is borrowing money from your broker to buy stock. You must open a margin account in which you deposit a minimum amount of cash or eligible securities. If you want to buy a stock, you can use some of the cash in your margin account and borrow the rest. The portion of your cash deposit used to buy the stock is called the *margin*. Margin requirements are set by the Fed. If you have $2,000 in your margin account and want to buy 100 shares of stock at $20 per share, you could use $1,000 from your margin account and borrow $1,000, with interest, from your broker. You are using a leverage strategy by borrowing money to buy stock. Because you can buy more stocks with less of your own money, you increase your chances of making a profit.

When buying on margin, you are betting that the stock will increase in value. In some cases, the value of the stock may drop by an amount equal to the margin. When this happens, the investor may receive a *margin call* from the broker. The investor would have to provide more money immediately or sell the stock to avoid defaulting on the loan. Buying on margin is a risky strategy. Figure 12-2.2 illustrates the process of buying on margin.

BUYING PATTERNS

When buying stocks and other investments, there are several buying patterns to consider. Each of these has its advantages and its disadvantages. Regardless of your buying pattern, you will find market timing important. You want to sell at prices that are higher than the amount you paid for investments.

Buy and Hold

buy and hold a plan to purchase and keep stock for the long term

Buy and hold is a plan to purchase and keep stock for the long term. Buy-and-hold investors make money in three ways. First, they will receive cash dividends over the years. Second, if the price of the stock goes up, they will have long-term capital gains when the stock is sold. Third, stock dividends or stock splits may occur, giving investors additional shares of stock.

Figure 12-2.2 Buying on Margin Example

1. Marco invests $5,000 and borrows $5,000 at an annual interest rate of 5 percent from a brokerage firm. He buys 500 shares at $20 per share ($10,000 purchase price). He uses the stock as collateral for the loan (as required by the Fed).
2. Six months later, the stock has increased in value to $30 per share. Marco sells the stock for $15,000 (500 × $30 = $15,000). He pays the broker commissions and fees of $150.
3. From his net proceeds of $14,850 ($15,000 – $150), Marco repays the $5,000 loan plus $125 interest ($14,850 – $5,125 = $9,725). When he subtracts the $5,000 originally invested, Marco has made $4,725 profit.

Note: There is no guarantee that the stock price will rise. If the stock price drops, Marco has to pay interest on the loan and wait to sell the stock. If he sells when the price has dropped, he will lose money (principal).

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Stock Turning

Some investors and experts believe that you should be moving your stock investments regularly. **Stock turning** is a strategy of making regular and systematic changes in stock ownership based on trends in the economy. With stock turning, you change your stock ownership on a regular basis, such as monthly or quarterly, or more often if it is warranted. Based upon observations of how stocks are doing, you sell one and replace it with another. For example, if energy stocks are falling but precious metals are rising, you would sell one and buy the other. Understanding the economy and its signals can help you do this. You will not always earn profits, but with careful timing, you may be able to gain more than you lose. The hope is that when you see a particular stock dropping, you can sell it before it hits bottom. And when you see a particular stock rising rapidly, you can buy it before it hits the top.

stock turning a strategy of making regular and systematic changes in stock ownership based on trends in the economy

Watch and Wait

The watch-and-wait investor will make a selection of securities and prepare a *comparative analysis* periodically, usually every two or three years. This strategy involves comparing how investments have done since the last analysis. It often also compares current choices to other possible choices in the financial marketplace. When the analysis is complete, the investor decides what to do. Some securities will be kept, some will be sold, and new securities will be added. This investor is doing more than asset allocation; he or she is doing a comprehensive examination of current investments while taking into account the changing market, industry, and economic conditions.

MANAGING COSTS

As you buy and sell your securities and other investments, you will want to manage your costs. There are techniques you can use to minimize your expenses. For example, when you use direct investing, you are able to save all fees of buying and selling. By using a reinvestment strategy that includes stock dividends and stock splits, you can avoid transaction fees and other costs.

Type of Transaction

Stockbrokers make money when stocks are bought and sold for clients. Some brokerage firms have minimum commissions of $25 to $60. Additional fees may be charged based on the number of shares and on the value of the stock being traded. On the trading floor of a stock exchange, stocks are traded in round lots or odd lots. A **round lot** is exactly 100 shares or multiples of 100 shares of stock. An **odd lot** is fewer than 100 shares of stock. When you buy less than a round lot, there is an additional fee. Thus, you can manage your costs of buying and selling by purchasing in round lots.

round lot exactly 100 shares or multiples of 100 shares of stock

odd lot fewer than 100 shares of stock

Using Discount Brokers

Using discount brokers rather than full-service brokers can save you money, which will leave you more money for investing. Discount brokers usually charge a flat fee per transaction. However, for odd lots or small amounts, they often charge higher fees. For example, when the trade amount is less than $1,000, the transaction fee may be higher.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Success Skills

READING THE STOCK LISTINGS

To make wise investments in the stock market, it is a good idea to track the progress of your chosen investments by reading the stock listings. Whether you are reading *The Wall Street Journal* or following your stocks online, you should see a listing similar to the table shown below.

Columns 1 and 2: These columns show the highest and lowest price this stock sold for during the year. For the ExeB stock, the high for the last 52 weeks was $57.00 and the low was $32.00.

Column 3: This column lists stocks alphabetically by name. You will notice that stock names are abbreviated. This abbreviated name is called the stock's *ticker symbol*.

Column 4: This column shows the cash dividend per share for the year, listed in dollars and cents. For the ExeB stock, 2.50 means that if you owned 100 shares of this company, you would have received a dividend of $250 for the year.

Column 5: Yld % stands for percent yield, or the percentage of the current price the dividends represent. Divide the amount of annual dividends (Column 4) by the closing price (Column 10).

Column 6: The P/E ratio (price/earnings ratio) is the price of a share of stock divided by the corporation's earnings (profits) per share over the last 12 months. If XYZ Corporation's stock is selling for $50 per share and its earnings per share are $10, the P/E ratio is 5 ($50/$10 = $5).

Column 7: This column shows sales in hundreds of shares from the previous day—how many round lots of stock were bought and sold. Multiply the number by 100 to get the number of shares.

Columns 8, 9, and 10: These columns show the highest, lowest, and closing price for this stock on the previous day. The closing price is the final price at the end of trading for the day.

Column 11: This column, called net change, compares the closing price today with the closing price of the day before. A minus means the price has gone down. A plus means the price has risen.

Try It Out

Using the stock listings in a newspaper or online, find and record the information described above for two stocks. Which stock paid higher dividends? Which stock had the smaller net change? Which stock had the lower P/E ratio? How can you use this information to make investment decisions?

52 wks					P/E	Sales				Net
High	Low	Stock	Div	Yld%	Ratio	100s	High	Low	Close	Change
1	2	3		45	6	7	8	9	10	11
58.75	44.00	Enger	2.20	4.8	12	109	46.38	45.50	46.00	–.50
57.00	32.00	ExeB	2.50	5.7	11	48	46.00	43.00	44.00	+1.00

Timing and Combining

Investors can also save money by making their trades all at once, rather than at different times. By timing purchases (and sales) so that they are bundled, you can save on total transaction fees. When buying and selling, investors should check with their full-service brokers, discount brokers, or bank financial advisers about ways to save fees and maximize returns.

CHECKPOINT ▸ ▸ ▸

How can you control your investment costs?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-2 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

____ 1. Exactly 100 shares or multiples of 100 shares of stock

____ 2. A plan to purchase and keep stock for the long term

____ 3. An order to buy (or sell) a stock that allows the broker to get the best possible price

____ 4. A strategy of making regular and systematic changes in stock ownership based on trends in the economy

____ 5. A request to buy (or sell) a stock at the current market price

____ 6. Borrowing money from your broker to buy stock

____ 7. Selling stock that has been borrowed from a broker

____ 8. A request to buy (or sell) a stock at a specific price

____ 9. Fewer than 100 shares of stock

a. buy and hold
b. buying on margin
c. discretionary order
d. limit order
e. market order
f. odd lot
g. round lot
h. selling short
i. stock turning
j. stop order

CHECK YOUR UNDERSTANDING

10. List four types of stock market orders.
11. List the steps in a stock buying transaction on a stock exchange.
12. How can you sell stocks by selling short? Is it risky?
13. How can you buy stocks on margin? Is it risky?
14. What are three ways to gain wealth by using a buy-and-hold strategy?
15. What is the purpose of stock turning?
16. How does the watch-and-wait strategy work?
17. What is an advantage of using a discount broker or an online broker rather than a full-service broker?
18. What is a disadvantage of using a discount broker or an online broker rather than a full-service broker?
19. How can you reduce the costs of stock purchases and sales by bundling trades?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

20. Why is it beneficial to check your brokerage accounts online?
21. Why would you choose a limit order or a stop order?
22. Why do some investors leverage stock purchases by selling short and buying on margin rather than pay cash for stocks?
23. Which of the three buying patterns would you choose? Why?

EXTEND YOUR LEARNING

Point Your Browser

www.cengage.com/school/pfinance/pfl

24. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 12. From the data files, open the Excel file *CH12 Stocks*. Assume you purchased Stock A on December 2 last year. In the spreadsheet, record the following closing prices for the stock at the beginning of the month for 6 months.

Date	Closing Price
7/1/20–	$71.86
8/1/20–	$80.92
9/1/20–	$83.91
10/1/20–	$85.45
11/1/20–	$88.50
12/1/20–	$85.00

a. Enter a formula in cell B24 to find the average price of the stock for the prices recorded. Enter a formula in cell B25 to find the highest price of the stock for the prices recorded. Enter a formula in cell B26 to find the lowest price of the stock for the prices recorded.

b. On March 30, you bought another 100 shares of Stock A at $69.00 per share. And on December 28, you sold 100 shares of that stock at $86.00 per share. Enter these data in the spreadsheet.

c. Enter a formula in cell F9 to find the average price per share for the stocks you purchased. (Multiply the price by the number of shares for each purchase. Add the two amounts. Divide by the total number of shares purchased.) Enter a formula in cell G6 to find the return on investment for the 100 shares you sold. You use a discount broker with very low fees, so you will not include the trade fees in the ROI calculation. Use the average price per share for the stocks you purchased in the ROI formula. (*Reminder*: ROI = Total Amount Received – Total Amount Paid / Total Amount Paid.)

d. Create a line chart to show the closing price for Stock A for each of the 12 prices recorded. Use *STOCK A PRICES* for the chart title. Do not include a legend. Save the chart on a separate sheet in the same file. Based on your chart, when could you have sold the 100 shares to receive a higher price? When would have been the best time to buy more of this stock between May 1 and September 1?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-3 Regulatory Agencies and Laws

GOALS

- Describe agencies that regulate and supervise the securities and financial industry.
- Explain how financial reform laws enhance consumer protections in the financial markets.

KEY TERMS

- oversight, p. 397
- National Credit Union Administration (NCUA), p. 398
- Financial Industry Regulatory Authority (FINRA), p. 398
- Pension Benefit Guaranty Corporation (PBGC), p. 398
- Commodity Futures Trading Commission (CFTC), p. 399
- Office of Thrift Supervision (OTS), p. 399
- Office of the Comptroller of the Currency (OCC), p. 399
- Securities and Exchange Commission (SEC), p. 400
- Sarbanes-Oxley (SOX), p. 401
- Wall Street Reform Act, p. 402

What Regulatory Agencies Help Consumers?

Banks, brokerage companies, and other financial businesses are limited and controlled by a number of agencies created by the U.S. Congress. These agencies make or enforce rules and regulations. Most of these agencies provide **oversight**, or supervision of activities to ensure that investors' rights are protected.

oversight a regulatory agency's supervision of activities to ensure that investors' rights are protected

FEDERAL DEPOSIT INSURANCE CORPORATION

The *Federal Deposit Insurance Corporation* (FDIC) is an independent agency created by Congress in 1933 in response to the bank failures in the 1920s and 1930s after the stock market crash of 1929. Its purpose is to promote public confidence in the banking system. It also supervises banks and other financial institutions to maintain a stable and sound banking system. It insures depositor accounts up to $250,000. (This amount is scheduled to be reduced to $100,000 in 2014.) The FDIC monitors practices at banks, including advising and investment activities, to assure that lawful and ethical practices are being used.

The FDIC also provides consumer resources. At the FDIC website, you can find information about many topics related to investing. Other topics of interest to consumers are also provided. For example, your right to financial privacy and how to avoid becoming a victim of identify theft are discussed.

©Gerry Boughan, 2010/Shutterstock.com

What is the FDIC's role in the economy?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

NET Bookmark

The Federal Deposit Insurance Corporation is an independent agency designed to promote public confidence in the banking system. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 12. Learn more about the FDIC by reading the article "The FDIC—Who We Are and Why You Should Know About Us." Then answer: What economic crisis resulted in the creation of the FDIC? Why do you think the FDIC was created then? What is the FDIC's main job? To how many bank failures has the FDIC responded?

www.cengage.com/school/pfinance/pfl

NATIONAL CREDIT UNION ADMINISTRATION

National Credit Union Administration (NCUA) an independent federal agency that charters and supervises credit unions

The **National Credit Union Administration (NCUA)** is an independent federal agency that charters and supervises credit unions. Savings deposits in member credit unions are insured through the National Credit Union Share Insurance Fund (NCUSIF) for up to $250,000 (to be reduced to $100,000 in 2014).

The NCUA provides resources for its credit union members. It also provides resources for consumers, including workshops and financial advising. The NCUA Share Insurance Estimator is available on the NCUA website (www.ncua.gov). It can be used to compute the amount of NCUSIF coverage available for different accounts.

FINANCIAL INDUSTRY REGULATORY AUTHORITY

Financial Industry Regulatory Authority (FINRA) a private, nonprofit organization that regulates firms selling securities in the United States

The **Financial Industry Regulatory Authority (FINRA)** is a private, nonprofit organization that regulates firms selling securities in the United States. FINRA monitors trading on the NASDAQ stock market and other selected markets. Nearly 4,700 securities firms are members of FINRA. It registers member firms, writes rules to govern their behavior, and enforces these rules. Firms that break the rules may be charged high fines to discourage illegal and unethical practices.

Protecting investors is a primary goal of FINRA. It monitors advertising related to securities to ensure that ads are accurate and not misleading. FINRA also tests and licenses stockbrokers. Investors can find information about licensed brokers on the FINRA website. FINRA provides materials in print and on its website to educate the public about investing. Its "Investor Alerts" provide current news about investment scams and problems.

PENSION BENEFIT GUARANTY CORPORATION

Pension Benefit Guaranty Corporation (PBGC) a federal corporation whose primary purpose is to protect the retirement incomes of workers with defined-benefit pension plans

The **Pension Benefit Guaranty Corporation (PBGC)** is a federal corporation whose primary purpose is to protect the retirement incomes of workers with defined-benefit pension plans. These pension plans are designed to pay a monthly benefit to retired workers. The amount is commonly based on the person's former salary and years spent on the job.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

The PBGC collects insurance payments from companies that offer pension plans to their workers. It also earns money from investments. When a PBGC-covered pension plan ends or fails for some reason, the PBGC pays some benefits to the retired workers. However, retirees may not get all the benefits promised by the company. For example, health care benefits may not be covered. The maximum benefit is set by law and varies according to the year in which your plan ended and your age at the date you begin receiving benefits. Maximum monthly benefits tables are provided on the PBGC website (www.pbgc.gov). You can also find information on the following topics at the website:

How does the PBGC help protect retired workers?

- How to find out if your pension plan is insured by PBGC
- How a pension plan can end
- What benefits likely will be provided to workers in the plan
- What survivor benefits are available
- How to start collecting pension benefits

COMMODITY FUTURES TRADING COMMISSION

The **Commodity Futures Trading Commission (CFTC)** is a government agency that regulates commodity, futures, and options markets in the United States. When the CFTC was first created, most futures trading took place in the agricultural sector. Over the years, futures trading has become varied and complex. Through effective oversight and regulation, the CFTC seeks to protect investors against manipulation, abusive trade practices, and fraud.

Commodity Futures Trading Commission (CFTC) a government agency that regulates commodity, futures, and options markets

OFFICE OF THRIFT SUPERVISION

The **Office of Thrift Supervision (OTS)** is a government agency (part of the U.S. Treasury) that provides supervision of thrift (savings and loan) institutions. It provides consumer information and handles consumer complaints in this area. The OTS examines thrift institutions periodically to ensure their soundness and compliance with consumer protection laws and regulations, including those that ensure fair access to financial services and fair treatment of consumers. You may find information about the OTS or file a complaint about a thrift institution at its website (www.ots.treas.gov).

Office of Thrift Supervision (OTS) a government agency that provides supervision of thrift (savings and loan) institutions

OFFICE OF THE COMPTROLLER OF THE CURRENCY

The **Office of the Comptroller of the Currency (OCC)** is a government agency dedicated to ensuring a safe and sound national banking system. The OCC was established in 1863 as a bureau of the U.S. Treasury. It seeks to provide information, resources, and recourse to consumers and

Office of the Comptroller of the Currency (OCC) a government agency dedicated to ensuring a safe and sound national banking system

©Rob Marmion, 2010/Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

small businesses. The OCC charters, regulates, and supervises all national banks. It issues rules, legal interpretations, and decisions about banking, lending practices, bank investments, community development, and other aspects of bank operations. The OCC has a national staff of bank examiners who supervise both national and international transactions.

SECURITIES AND EXCHANGE COMMISSION

Securities and Exchange Commission (SEC) primary overseer and regulator of the U.S. securities market

The **Securities and Exchange Commission (SEC)** is the primary overseer and regulator of the U.S. securities markets. It oversees securities exchanges, brokers and dealers, investment advisers, and mutual funds. The SEC works with other federal and state agencies and with private organizations, such as FINRA.

The SEC tries to maintain fair and orderly markets and promote business growth. It also enforces securities laws. Typical law violations include insider trading, accounting fraud, and the issuance of false information about companies or securities. The primary goal of the SEC is to protect investors. The SEC requires public companies to provide meaningful and accurate data to the public, including financial reports. Having this data helps investors make informed investment decisions.

DEPARTMENT OF THE TREASURY

The *U.S. Department of the Treasury* is the primary federal agency responsible for the economic security of the United States. It has a wide range of duties related to financial issues. It seeks to help citizens by maintaining a strong economy that creates growth and job opportunities.

Information about many saving and investing topics is available online at the Department's website (www.ustreas.gov). The Department of the Treasury is a member agency of the U.S. Financial Literacy and Education Commission. The commission has a website called MyMoney.gov, which is dedicated to teaching the basics of financial education. Tools such as calculators, budgeting worksheets, and checklists are available at the website. You can also order a free *My Money* tool kit. The site also provides consumers with information about topics such as saving and investing, privacy, retirement planning, and starting a business.

INTERNAL REVENUE SERVICE

The *Internal* Revenue *Service (IRS)* is a bureau of the U.S. Department of the Treasury. Its role is to help taxpayers understand and meet their tax responsibilities. It also seeks to ensure that those who owe taxes pay them. Both interest (from bonds) and cash dividends (from stocks) are forms of taxable income and must be reported on tax returns.

Schedule D for Form 1040 is used to report details of stock trades. Taxpayers should read the tax form instructions carefully to be sure all investing activity is properly reported. Taxpayers who have many

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

investments and several transactions during the year may want to hire a trained tax preparer to complete the forms.

What is the primary role of the IRS?

THE FEDERAL RESERVE SYSTEM

The *Federal Reserve System* (the Fed) is the central bank of the United States. Its purpose is to provide the nation with a safe and flexible financial system. Its activities are in four general areas as follows:

- Setting monetary policy
- Providing financial services to the U.S. government, financial institutions, and the public
- Supervising and regulating the banking system
- Keeping the country's financial systems and markets stable

The Federal Reserve System is covered in more detail in Chapter 5 on banking systems.

CHECKPOINT

How do regulatory agencies help consumers?

What Are Financial Reform Laws?

Financial reform laws are designed to protect consumers as they participate in the financial markets. Regulatory reform has been deemed necessary because of large-scale fraud that has taken place in the financial markets. Such fraud can lead to economic consequences, including recession, business failures, job loss, devaluation of stocks, and severe financial distress.

SARBANES-OXLEY

The Public Company Accounting Reform and Investor Protection Act of 2002, more commonly known as **Sarbanes-Oxley (SOX)**, set new and stronger standards for public companies and accounting firms regarding the reporting of financial results of business operations. The law was created in response to financial scandals at large companies. These scandals involved fraud or misconduct by company officers that resulted in losses for investors and company employees. SOX requires improved financial reporting, audits, and accounting services for public companies. It also established the Public Company Accounting Oversight Board, an agency that oversees and regulates accounting firms in their roles as auditors of public companies.

Sarbanes-Oxley a law that set new and stronger standards for public companies and accounting firms regarding the reporting of financial results of operations

©Mehmet Dilsiz, 2010/Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Building Communications Skills

PERSUASIVE MESSAGES

The goal of a *persuasive message* is to convince the reader to take (or not take) some action. For example, you may want the reader to buy a product or donate money to a charity.

It is tempting to write a very long message to persuade someone to do as you think he or she should. However, long messages are often discarded without being read. People may not read a long and detailed message unless they have asked for it. Thus, the message must be concise as well as clear and convincing.

You must gain the reader's attention and give solid reasons for the person to take action. The reader may have an opinion or bias that you must overcome. Your arguments must be logical and appealing. In the first paragraph, give one good reason why the reader should keep reading. In the middle paragraph(s), explain your position and give evidence to support it. In the final paragraph, give the reader a reason to take action or accept your position. Use a positive tone throughout the message.

Try It Out

Write a letter to sell an idea to another person. For example, you may want the receiver to invest in your new business or become an investment partner in another venture. Explain what you need and what the reader will gain from the transaction.

Wall Street Reform Act a law that is designed to create and maintain a stable financial system

DODD–FRANK WALL STREET REFORM

Officially known as the *Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010*, simplified as the **Wall Street Reform Act**, this law is designed to create and maintain a stable financial system. It aims to decrease risk in the financial system by imposing regulations to enhance investor and consumer protections throughout the system. The imposed requirements will affect more than the financial markets of Wall Street. Businesses across all financial services, not just banking, will feel the impact. There will be tighter restrictions on the use of leverage and risk-taking as well as higher liquidity requirements. These restrictions may mean lower profit margins from certain investment activities. There will be more monitoring of any financial market activity that could cause the stock markets to drop in value steeply within short periods of time. The law will also affect consumers in many ways, as described below.

A New Consumer Agency

The act established the Consumer Financial Protection Bureau that will be housed in the Federal Reserve. Fees paid by banks will fund the agency. The agency will set rules to help prevent unfair practices related to consumer loans and credit cards.

Credit Scores

All consumers can get one free credit report a year from the credit bureaus. This provision of the act also permits the consumer to get an actual credit score along with that free credit report.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Interchange Fees

The act cracks down on debit card "swipe fees" that retailers pay to banks when their customers buy products and services using debit cards. The Fed will be able to cap those fees and make them more reasonable and proportional to the amount of the purchase.

©Olivier Le Queinec, 2010/Shutterstock.com

How did liar loans contribute to the 2008–2010 housing collapse?

Liar Loans

Lenders are now required to document a borrower's income before originating a mortgage loan and must verify the borrower's ability to repay the loan. Part of the problem that caused the housing collapse in 2008–2010 was the number of mortgages made to consumers who could not afford to make the payments. They did not have to "qualify" for those mortgages; the loans were granted on stated (undocumented) income rather than verified income.

Mortgage Help for the Unemployed

The act allows unemployed homeowners with good credit to take out low-interest loans to help them avoid foreclosure. This program is funded with $1 billion from the Emergency Homeowners' Relief Fund, which will be administered by the U.S. Department of Housing and Urban Development (HUD).

New Oversight Power

The act creates a new ten-member oversight council consisting of financial regulators that will monitor financial firms and the financial system for problems. The Treasury Secretary gains a key role in enforcing tougher regulations on larger firms and watching for systemic risk (risk of collapse of the entire financial system).

FDIC Takeovers

The act gives the FDIC new power to take over and liquidate giant financial firms in the same way it takes over banks whose failure would jeopardize the financial system. Banks and financial firms will be taxed to reimburse the government for the costs of resolving the situation after a failure occurs. Taxpayer money will not be used to cover these costs.

CHECKPOINT

What is the purpose of Sarbanes-Oxley?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

12-3 Lesson Assessment

KEY TERMS REVIEW

Match the terms with the definitions. Some terms may not be used.

_____ 1. A government agency dedicated to ensuring a safe and sound national banking system

_____ 2. A federal agency that charters and supervises credit unions

_____ 3. A government agency that provides supervision of thrift (savings and loan) institutions

_____ 4. A regulatory agency's supervision of activities to ensure investors' rights are protected

_____ 5. A government agency that regulates commodity, futures, and options markets

_____ 6. Primary overseer and regulator of the U.S. securities market

_____ 7. A private, nonprofit organization that regulates firms selling securities in the United States

_____ 8. A law that sets new and stronger standards for public companies and accounting firms regarding the reporting of financial results of business operations

a. Commodity Futures Trading Commission (CFTC)
b. Financial Industry Regulatory Authority (FINRA)
c. National Credit Union Administration (NCUA)
d. Office of the Comptroller of the Currency (OCC)
e. Office of Thrift Supervision (OTS)
f. oversight
g. Pension Benefit Guaranty Corporation (PBGC)
h. Sarbanes-Oxley
i. Securities and Exchange Commission (SEC)
j. Wall Street Reform Act

CHECK YOUR UNDERSTANDING

9. What is meant by government oversight of the securities industry?
10. What is the purpose of the Pension Benefit Guaranty Corporation?
11. What prompted passage of the Sarbanes-Oxley Act of 2002? How does this law help protect consumers and investors?
12. What is the primary federal agency responsible for the economic security of the United States? How does it help citizens?
13. Who sponsors the MyMoney.gov website? What types of information and tools are available on the site?
14. What services does the IRS offer consumers? What do investors need to do to be in compliance with IRS rules?

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

THINK CRITICALLY

15. Why did Congress create the FDIC in 1933? Is it still needed today?
16. How does FINRA help protect investors? Why does it impose fines against member firms?
17. How would investors be affected if public corporations did not have to report financial data as required by the SEC?
18. Why are financial reform laws dealing with the stock market needed?
19. How does the Wall Street Reform Act benefit consumers?
20. The Wall Street Reform Act gives the FDIC the power to take control of financial firms that are failing. Do you think the FDIC should have this power? Why or why not?

EXTEND YOUR LEARNING

21. Investors who sell stocks and bonds (except for retirement investment accounts) will need to complete Schedule D of tax Form 1040. Access **www.cengage.com/school/pfinance/pfl** and click on the link for Chapter 12. From the data files, open the PDF file *CH12 Schedule D*. Print the form. Write your name and use 000-22-1111 as the social security number. Assume you had the investment activities shown in the tables below.

    a. Part I of the form is used to report the sale of assets held for one year or less. The *Sales Price* is the amount you received less any trading fees. The *Cost or Other Basis* is the amount you paid for the stock plus trading fees. Enter the data in Part I, line 1, of the form.

Description of Property	Date Acquired	Date Sold	Sales Price	Cost or Other Basis
Stock A, 100 shares	4/1/2009	9/30/2009	$1,050	$900
Stock B, 300 shares	3/20/2009	11/3/2009	$3,000	$2,500

    Calculate the amount of gain or loss for each stock. Enter the amount in Part I, column F, of the form. Total the short-term sales price amounts. Enter the amount on line 3. Leave lines 4, 5, and 6 blank. Find the total of Part I and enter the amount on line 7, column F.

    b. Part II of the form is used to report activity for assets held more than one year. Enter the following data in Part II on line 8:

Description of Property	Date Acquired	Date Sold	Sales Price	Cost or Other Basis
Stock C, 200 shares	5/15/2006	8/30/2009	$3,000	$2,400
Stock D, 100 shares	6/20/2008	7/31/2009	$900	$1,000

    Find the total of the sales prices in column D. Enter this amount on line 10. Calculate the amount of gain or loss for each stock. Enter the amount in Part II, column F. Enter any amount that is a loss in parentheses. Complete the rest of Schedule D.

Point Your Browser

www.cengage.com/school/pfinance/pfl

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Exploring Careers in...

AGRICULTURE

Everyone buys food products for consumption in their homes. Much of this food is grown or raised in the agricultural industries in the United States. Much of the work is outdoors, working with livestock and crops. Other work is in areas related to processing or marketing food or natural resources.

Forestry and fishing are also important sectors that provide food and nonfood products to make our lives more comfortable.

Large "agribusinesses" are producing more than 75 percent of all food and other consumable products. Livestock and crops are produced very efficiently in the modern farming environment. Production is concentrated in certain areas of the country, depending on climate, soil condition, weather patterns, availability of water, and topography.

Government positions are also important in forestry, agriculture, parks and recreation, inspection, and quality control.

Employment Outlook

- Employment growth is projected to have little or no change through 2018 as family farms are replaced with agribusiness enterprises.

Job Titles

- Rancher
- Farmer
- Game warden
- Park ranger
- Fishers
- Farm manager

Needed Education/Skills

- Self-employment skills and experience in agriculture, mechanics, and equipment operation are important.
- Computer skills and management skills are becoming more important to keep costs at a minimum.

What's it like to work in . . . Agriculture

Jeremy works at a dairy farm where he handles 300 cows every day, making sure they are properly cared for, including feeding and milking them twice a day. Jeremy enjoys working with the animals and taking care of them to ensure they are healthy.

The milking barn contains modern equipment used for milking. Jeremy is responsible for making sure all equipment is working properly, that sanitary requirements are being met, and that the milk meets standards for sales and shipment. Today Jeremy is supervising the installation of a new device that will streamline the milking process and provide a better filter for the milk as it passes into the holding tanks.

What About You?

Do you like working outdoors? Are you good at making plants grow? Do you enjoy caring for animals? Do you like science and finding more efficient ways of doing things? Would a job in agriculture, forestry, or fishing appeal to you?

©T-Design, 2010/Shutterstock.com

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Chapter 12 Assessment

SUMMARY

12-1 Investors should do thorough research before buying stocks, bonds, or other investments. Financial information can be found in magazines, newspapers, investor newsletters, company reports, prospectuses, and the Internet.

Professionals, such as stockbrokers, financial planners, and licensed personal bankers, can help investors choose securities to buy or sell.

Securities can be traded in the primary or secondary market. When buying in the primary market, investors buy directly from the issuer. When buying in the secondary market, investors buy from a previous owner.

Securities exchanges are auction markets, where stocks are sold to the highest bidder. The over-the-counter market is a network of brokers and dealers who sell stocks not listed on an exchange.

Direct investing is buying securities directly from a corporation. Direct investing allows investors to avoid transaction fees.

12-2 You begin investing by setting up a brokerage account. Four different types of stock market orders can be placed when trading on a securities exchange: market orders, limit orders, stop orders, and discretionary orders. Brokers will place orders on your behalf in auction and over-the-counter markets.

Investors can use cash or credit in completing stock purchases. Selling short and buying on margin are two leverage strategies for buying stocks. Both techniques can be risky.

Investor buying patterns include buy and hold, stock turning, and watch and wait. Each of these is based on an understanding of the market and market timing of purchases and sales.

Investors can reduce investment costs by purchasing in round lots and by using discount brokers and direct investing.

12-3 Many regulatory agencies regulate and control the financial markets. They seek to protect consumers by providing stable markets and enforcing fair trading practices.

The Sarbanes-Oxley Act of 2002 helps protect consumers by setting forth new and stronger reporting standards for U.S. public companies and for accounting firms.

The Wall Street Reform Act of 2010 was designed to decrease the risk in the financial system by increasing monitoring activities and imposing tighter regulations to protect investors and consumers.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

MAKE ACADEMIC CONNECTIONS

1. **Math** Answer the following questions:
   a. You plan to buy 100 shares of stock for $45.00 per share. If you use a full-service broker, the fee will be a 2 percent commission on the purchase price. Investment advice is included at no extra cost. What will be the amount of the commission you must pay? If you use a discount broker, you will pay a fee of $9.95 for the round-lot purchase. No investment advice is provided. You have already paid $100.00 for an investment newsletter to help you decide which stock to buy. Which broker would you use and why?
   b. You plan to buy 35 shares of stock for $22.18 per share. If you use a full-service broker, you must pay a 2 percent commission on the purchase price. You must also pay $10.00 because it is an odd-lot sale and $15.00 because it is a small purchase. What is the total amount you must pay? If you use a discount broker, you will pay a fee of $34.95 for the odd-lot purchase. You have already paid $100.00 for an investment newsletter to help you decide which stock to buy. Which broker would you use and why?
2. **History** Select a regulatory agency that provides information, assistance, and protections for consumers and/or investors. Research the history of the agency—when it was formed, what its original mission was, and what it does today. Visit its website and gather information about the state of the country and the economy at the time the agency was formed. Give a presentation of your findings. State whether you believe the agency is meeting its mission and whether the agency is still needed today.
3. **Communication** You are on the board of directors for a new corporation. Instead of paying cash dividends to the stockholders this year, you think it would be in the corporation's and stockholders' best interest to pay stock dividends. Write a persuasive letter to the other board members asking them to take this action.
4. **Math** You want to leverage your investment by selling short. You borrow 100 shares of stock in XYZ corporation from your broker on January 2. You immediately sell all 100 shares at $60 a share. On April 1, you instruct your broker to purchase 100 shares of XYZ stock at $53 a share, which you return to your broker. What is your return on investment?
5. **Economics** In the decade following the stock market crash of 1929, many new federal laws were passed, and many new federal agencies were created. Research that ten-year period of time and write a paper explaining what was occurring in the economy that called for new regulations, laws, and agencies. Is it possible for such an economic event to happen today?
6. **Consumer Economics** Visit the website MyMoney.gov, which is sponsored by the U.S. Treasury. View several of the resources and tools available. Prepare a presentation describing two of the resources and/or tools. Explain how they could be useful for consumers who need some help managing their finances.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

7. **Ethics** Brokers earn fees for buying and selling securities for clients. The more trades they make, the more money they earn. When a broker is constantly buying and selling stocks for a client, the client may or may not be making profits. Trading securities primarily to make money from sales commissions is called *churning*. Churning is illegal under rules of the SEC. Churning can be hard to prove. Investors sign a waiver that states brokers are not responsible for losses in stock trades. How will you know if churning is occurring? What should you do if you think you have been a victim of churning? What advice would you give others to avoid becoming a victim of churning?

Take Action

RESEARCH AN INVESTMENT CHOICE

Before buying stock in a company, investors should learn about the company, its history, and its outlook for the future. Work with a classmate to complete the following steps:

a. Choose a company that interests you to research. It can be a company with which you are familiar, such as Coca-Cola, General Motors, or Walmart. It can be a company you find listed on the NYSE or NASDAQ.

b. Do research to learn all you can about the company. Look for information in magazine and newspaper articles and on the Internet. If possible, get a copy of the company's annual report. Keep a record of the source information for all the articles you read, whether in print or online.

c. Write a report or give an oral report to present what you have learned about the company. Include several of the following points and others that you think would help an investor decide whether to buy stock in the company.

- Company name and trading symbol
- Industry to which the company belongs
- Major products or services the company sells
- Company headquarters location
- Number of employees
- Brief history of the company
- Plans for expansion or new products
- Other topics in the news related to the company
- Current stock price
- Range of stock prices over the last year
- Revenue and income for last year
- P/E ratio and current ratio
- Dividends paid
- Stock splits
- Risk level for the company stock

Include the information you have collected about the company in your portfolio.

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Glossary

401(k) plan a tax-deferred retirement plan funded by employees of profit-seeking businesses

403(b) plan a tax-deferred retirement plan funded by employees of government and nonprofit organizations

A

access checks checks provided by a credit card company that allow you to borrow against your credit card account

advance-fee loans a type of loan that includes a large upfront fee

advertising informing consumers about products and encouraging them to buy

alternative dispute resolution (ADR) a method of settling a dispute using a neutral third party

annual fee a yearly charge to your account for membership

annual report a company's report to shareholders about the financial position of the company

annuity a fixed amount set aside on a regular basis over time; a contract purchased from an insurance company that guarantees a series of regular monthly payments for a set time

asset allocation choosing a combination of funds within a single mutual fund company

assets money and items of value that you own

auction market a market in which a stock is sold to the highest bidder

automobile insurance a policy that protects a car owner from losses as a result of accidents and other events

B

bait and switch an illegal sales technique in which the business advertises a bargain product with the intent of persuading consumers to buy a more expensive product

balance transfer moving a balance from one credit card account to another

balloon payment a large lump-sum payment that must be paid at a set time

bank reconciliation the process of adjusting the checkbook register and bank statement balances so that they agree

bankruptcy a legal procedure to relieve a person of excessive debt

bankruptcy fraud the abuse of bankruptcy laws in a way that favors the debtor and defrauds creditors

banner ads Internet ads that span the top, bottom, or sides of a web page

bear market period in the stock market when prices are steadily decreasing

benchmarks standards against which progress is measured

beneficiary the person designated to receive money from a life insurance policy

benefits forms of pay other than salary or wages

billing cycle time period during which you must make your monthly payment

bond a debt instrument issued by a corporation or government

bounced check a check that is not honored by a bank and is returned to the payee's bank due to nonsufficient funds

branding strategy carrying well-known brand names to attract customers who are loyal to those brands

budget a spending and saving plan based on expected income and expenses

bull market period in the stock market when prices are steadily increasing

business cycle the alternating periods of growth and decline in the economy

buy and hold a plan to purchase and keep stock for the long term

buying on margin borrowing money from your broker to buy stock

buying plan an organized method for making good buying decisions

C

callable bond a bond with a clause that allows the issuer to repay the bond early

cancellation fee a penalty for closing your account prior to a stated period

cash inflows income from your job, investments, and other sources

cash outflows expenses, or items for which you must spend money

cashier's check a check issued against the bank's funds

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

certificate of deposit (CD) a time deposit that pays a fixed rate of interest for a specified length of time

Chapter 7 bankruptcy the forfeiture of an individual's assets in exchange for the discharge of debts

Chapter 11 bankruptcy reorganization of debt as decided by the court so that a business can remain viable

Chapter 13 bankruptcy a repayment plan for debt for individuals

charge card a form of credit card where the balance must be paid in full each month

charitable giving the act of donating money or time to a cause in which you believe

check a written order to a bank to pay a stated amount to a person or business

checkbook register a tool used to track checking account transactions

checking account a demand deposit in a bank on which checks are drawn

clearing account an account used to buy and sell investments

collateral property used as security for a loan

collectibles rare, valuable objects, such as fine art, coins, decorative plates, books, and baseball cards

collision coverage a policy that protects against damage to your own vehicle if you hit another car or lose control and roll over

commission a set fee or percentage of a sale paid to an employee instead of or in addition to salary or wages

commodity an item that has the same value across the market with little or no difference in quality among producers

Commodity Futures Trading Commission (CFTC) a government agency that regulates commodity, futures, and options markets

common stock stock that pays variable dividends and gives owners (stockholders) voting rights

comparison shopping the process of checking prices among several sellers to make sure you are getting the best price for what you buy

compound interest interest earned on both principal and previously earned interest

comprehensive coverage protection against damages to your car from causes other than collision or rolling over

consideration something of value exchanged for something else of value

consumer advocacy process of helping consumers resolve problems

consumer finance company a lender that generally extends high-interest loans to consumers who may be ineligible for other types of loans

consumer loan a direct loan of cash made to a consumer at a fixed interest rate for a set period of time

contact a person you know, such as a relative or friend

contingencies unplanned or possible events

contract a legally binding agreement that specifies the rights and duties of each party

convertible bond a bond that can be exchanged for shares of common stock at the option of the bondholder

cost-plus pricing setting a price based on production cost plus markup

cost-push inflation rising prices as a result of rising production costs

cost-recovery pricing setting an introductory price high to recover the R&D costs

coupon rate the fixed rate of interest that is paid semiannually for the life of a bond

cover letter a letter that accompanies a resume, introducing the applicant to a prospective employer

credit the ability to borrow money and pay it back later

credit card plastic card linked to a credit account that can be used to make purchases

Credit Card Act of 2009 a comprehensive reform to credit card law to establish fair practices related to credit

credit card fraud intentionally using someone's credit account to steal money or goods

credit counseling a service to help consumers manage credit and avoid bankruptcy

credit delinquency failure to pay debts as required by agreement or by law

credit protection service a plan that provides credit monitoring for a fee

credit repair a scam in which a company claims to be able to "fix" your poor credit record and give you a clean credit history

criteria standards or rules by which something is judged

customer loyalty program a program designed to encourage a customer's repeat business by providing discounts and other incentives

D

debit card a card used to withdraw or deduct money from your checking account

debt consolidation the process of getting one loan with a single monthly payment to pay off all of your debts

debt repayment plan a strategy for paying off debt in a way that reduces total interest paid

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

deception false or misleading claims made about the quality, price, or purpose of a product

deflation decrease in the general level of prices for goods and services

demand the willingness and ability of consumers to buy goods and services

demand-pull inflation higher prices as a result of consumers wanting to buy more goods and services than producers supply

dependent a person who depends on you for more than half of his or her support

deposit money added to a checking or savings account

direct advertising distribution of product information directly to consumers

direct investing buying stocks and other investments directly from companies and holding them

disability insurance insurance that provides income to replace a portion of normal earnings when the insured is unable to work due to nonwork-related injury or illness

discharge a court order that pardons the debtor from having to pay debts

discount bond a bond that is sold for less than its face value

discount broker a qualified stockbroker who buys and sells securities at a reduced commission but offers no advice

discount pricing offering the lowest everyday price possible

discretionary order an order to buy (or sell) a stock that allows the broker to get the best possible price

disinflation rising prices with the rate of increase slowing down

disposable income money available to spend or save after taxes have been paid

dispute letter a letter written to inform a credit company of an incorrect charge on your account

disputing a charge the process of informing a credit company of an error on your bill

diversification holding a variety of investments for the purpose of reducing overall risk

dividends a portion of a corporation's profits distributed to stockholders

documentation records that support your claim

dollar-cost averaging investing the same amount of money on a regular basis regardless of market conditions

down payment cash deposit toward the purchase price

E

early withdrawal penalty a fee imposed to discourage depositors from withdrawing the money before the stated time period

easy access credit types of credit that can be obtained quickly and easily but often come with high and hidden costs

economizing saving as much as possible and spending money only when necessary

economy all of the activities related to making and distributing goods and services in a geographic area or country

electronic funds transfer the use of a computer-based system to move money from the drawer's account to the payee's account

electronic records soft-copy formats of your financial information stored on your computer

emergency fund money set aside for unplanned expenses

emotional buying process of purchasing products based on desire rather than logic

encryption process of converting data to a coded form

endorsement a signature, with or without instructions, written on the back of a check

entrepreneur a person who takes the risks of being self-employed and owning a business

Equal Credit Opportunity Act a law that protects consumers from discrimination in the granting or denying of credit

equity loan a second mortgage or debt secured with the equity in your home

equity stripping the unethical practice of extending a loan to a distressed homeowner who cannot afford the loan payments, resulting in the lender taking possession of the home

estate all that a person owns (assets), less debts owed, at the time of that person's death

ethics a set of moral values that people consider acceptable; the study of what is right versus wrong

eviction the process of expelling a tenant from rented property

excise taxes taxes charged on the purchase of specific goods and services

exemption a person claimed as a dependent on a tax return; property that a debtor in bankruptcy does not have to forfeit to pay off creditors

extended warranty additional coverage that you can buy to pay for repairs or replacements needed beyond the original warranty period

F

Fair Credit Billing Act a law that sets requirements for resolving billing disputes

Fair Credit Reporting Act a law that grants you the right to know what is in your credit file

Fair Debt Collection Practices Act a law that protects consumers from abusive practices by creditors and collection agencies

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

fee-for-service plan a type of health insurance plan that allows the patient to choose medical providers (unmanaged care)

financial aid money you receive from an outside source to help pay for education

financial goals plans for how you will pay for your personal goals

Financial Industry Regulatory Authority (FINRA) a private, nonprofit organization that regulates firms selling securities in the United States

financial irresponsibility failing to live up to your financial obligations to meet your goals and needs

financial market a place where investments are bought and sold

financial plan a plan listing personal and financial goals along with steps and a timeline for reaching them

financial planner a professional consultant who provides financial advice for a fee or commission

financial resources money or other items of value that are used to acquire goods and services

financial responsibility being able to meet your financial goals through planned earning, spending, and saving

financial security the ability to meet current and future needs while living comfortably

financing options ways you can pay for an item other than with cash

fixed expenses costs that do not change each month

fixed interest rate interest rate that does not change from month to month

floating a check writing a check and planning to make a deposit later to cover it before the check is processed

follow-up contact with a prospective employer after the interview but before a person is hired for the opening

foreclosure the legal process of taking possession of a house (property) when a borrower does not make mortgage payments as agreed

Form 1040EZ the short tax return form designed for single and joint filers with no dependents or itemized deductions

Form W-2 a form used to report taxable income a worker received during the calendar year

foundation a fund or an organization established and maintained for the purpose of supporting an institution or a cause

franchise a contract that gives you the right to sell a company's products and services

full-service broker a qualified stockbroker who provides advice about what securities to buy and sell

futures contract an agreement to buy or sell a specific commodity or currency at a set price on a set date in the future

G

garnishment a legal process that allows part of an employee's paycheck to be withheld for payment of a debt

gems natural, precious stones such as diamonds, rubies, sapphires, and emeralds

goal a desired outcome based on one's values for which a plan of action is carried out

grace period the amount of time you have to pay your credit card bill without having to pay interest on your new purchases

grant money given to pay for educational expenses that does not have to be repaid

gross pay total salary or wages earned during the pay period

H

hard skills measurable physical and mental abilities that allow you to complete a job

headhunter an employment specialist who seeks out highly qualified people to fill upper-level positions for an employer

health insurance a plan for sharing the risk of medical costs from injury or illness

health maintenance organization (HMO) a group plan that provides prepaid medical care for its members

home inventory a list of items of value in your home; used for insurance purposes

homeowner's insurance a policy that protects against risk of loss to a home and its contents

hyperinflation rapidly rising prices that are out of control

I

identity theft the use of your personal information by someone else to commit fraud or other crimes

illiquid not convertible to cash quickly or without a penalty

impulse buying purchasing something on the spur of the moment without any planning

in-cash payments money in the form of check, debit card, or other direct payment given to a person needing assistance

in-kind payments payments made indirectly on a person's behalf or in a form other than money

inactive account a checking or savings account that does not meet minimum usage requirements

indirect investing buying shares of a mutual fund instead of buying individual shares of stock in various companies

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

industry risk chance that factors affecting an industry as a whole will negatively affect the value of an investment

inflation increase in the general level of prices for goods and services

inflation risk chance that the rate of inflation will be higher than your investment rate of return

infomercial a lengthy paid TV ad that includes testimonials, demonstrations, and introductory prices

installment credit credit used to finance a single high-priced item through a series of equal payments made over a set period of time

interest money earned on savings accounts and other funds

Internet banking accessing and managing your account online

introductory rate a low temporary interest rate offered when you open a new account

investing a strategy to earn more on your money than the rate of inflation

investment club a group of people who pool their money together to buy and sell investments

investment portfolio a collection of assets that provides diversification for an investor

investment risk potential for change in the value of an investment

investment tracking technique for making investment choices by following the prices of stocks over time

J

job application a form that asks basic questions about the applicant's background, such as work history, education, skills, and references

job description describes what a job would be like, including tasks performed and skills needed

job interview a face-to-face meeting with a potential employer to discuss a job opening

job market the job openings that are available when you are ready to go to work

job shadowing spending time observing a worker in a type of job that interests you

K

Keogh account a tax-deferred retirement plan for self-employed professionals

L

lease a rental agreement that specifies the rights and duties of the landlord and tenant

liabilities debts that you owe

liability coverage protection against injuries suffered by others on your property or as a result of your actions

life insurance insurance that pays money to the beneficiary upon the death of the insured person

limit order a request to buy (or sell) a stock at a specific price

line of credit a preapproved loan amount that a debtor can borrow against, pay back, and borrow again as needed

liquidity a measure of how quickly an asset can be turned into cash

living habits your daily routine, or the way you choose to live your life

loan modification a new loan arrangement that allows you to make reduced payments, usually on a temporary basis

loan shark a person who offers illegal unsecured loans at very high interest rates

logistics the act of making a plan and carrying it out to ensure an event takes place

long-term goals things you expect to achieve more than five years from now

loss a physical injury, damage to property, or disappearance of property

low-balling advertising a basic service at an unusually low price and then claiming additional repairs or services are needed

M

manual records information recorded using pen and paper

market-based pricing setting prices to be competitive with prices of similar products currently being sold

market economy an economy based on the laws of supply and demand

market order a request to buy (or sell) a stock at the current market price

market timing buying and selling stocks based on what the market is expected to do

market value the highest price a property will bring on the open market

markup the percentage a mount added to production cost to obtain the price of an item

maturity value a bond's future value as stated on its face

Medicare tax a tax that pays for medical care for retired persons

medium-term goals things you expect to achieve in the next two to five years

minimum payment the amount you are required to pay each month on a credit account

minimum wage the lowest pay rate allowed by law for each regular hour of work

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

money market account a type of savings account that earns the market rate of interest on the money deposited

money order a type of check used to pay bills or make payments for which the money is guaranteed

mortgage a long-term debt agreement used to purchase real estate

mutual fund a professionally managed group of investments bought using a pool of money from many investors

N

National Credit Union Administration (NCUA) an independent federal agency that charters and supervises credit unions

needs things needed for survival, such as food, clothing, shelter, and medical care

net pay the amount of your paycheck after deductions

net worth the difference between your assets and your liabilities

normal profit a profit that allows a business to survive and grow

O

odd lot fewer than 100 shares of stock

Office of the Comptroller of the Currency (OCC) a government agency dedicated to ensuring a safe and sound national banking system

Office of Thrift Supervision (OTS) a government agency that provides supervision of thrift (savings and loan) institutions

on-the-job training learning as you do the work

opportunity cost the value of your next best option—what you are giving up

optimizing getting the highest value for the money spent

over-the-counter (OTC) market a network of dealers and brokers who buy and sell stocks and other securities that are not listed with a securities exchange

over-the-limit fee a penalty charged when you exceed your approved credit limit

overdraft protection a bank service that covers a shortage in your account

oversight a regulatory agency's supervision of activities to ensure that investors' rights are protected

overtime pay pay received for hours worked in addition to regular hours

P

penalty a fee charged for violating a term of the credit agreement

Pension Benefit Guaranty Corporation (PBGC) a federal corporation whose primary purpose is to protect the retirement incomes of workers with defined-benefit pension plans

permanent life insurance a policy that provides a death benefit and builds cash value

personal goals things you want to achieve in your life

personal injury protection (PIP) coverage for medical, hospital, and funeral costs of the insured and passengers in the event of an auto accident

personal leave paid time away from work for personal reasons

phishing a scam in which an e-mail is sent from someone posing as your bank or other legitimate business asking for personal information

pigeon drop a scam in which a con artist convinces a person to give up his or her money in return for a share of a larger sum of money

political risk chance that a political event will affect the value of an investment

Ponzi scheme a fraudulent investment operation in which money collected from new investors is used to pay off earlier investors

pop-up ads Internet ads that open a new window that pops onto the screen in front of the web page being viewed

postdated check a check written with a date that will occur in the future

preapproved loan a loan for which a maximum amount is established and approved in advance

precious metals rare metals, which are usually natural substances, that have known value around the world

preferred provider organization (PPO) a network of independent health care providers that work together to provide health care services

preferred stock stock that guarantees a fixed dividend but does not provide voting rights

premium the price you pay for insurance coverage

premium bond a bond that is sold for more than its face value

prepayment penalty a fee charged if you repay a loan before the agreed-upon time

primary market the financial market in which new issues of securities are sold

principal sum of money set aside on which interest is paid

probability the likelihood of a risk resulting in a loss

productivity a measure of the efficiency with which goods and services are made (comparison of total output to total inputs)

profit-sharing plan a benefit whereby employees may share in the profits of the business

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

property manager a person hired to take care of rental property and to communicate with tenants on behalf of the owner

property taxes wealth taxes based on the assessed value of owned real estate

public goods government-provided goods and services paid for by taxes

pyramid scheme an illegal multilevel marketing gimmick that promises commissions on one's own sales as well as on the sales of recruits

R

rational buying process of selecting goods and services based on need, want, and logical choices

real-cost inflation rising prices due to scarce resources or increased difficulty in obtaining resources

rebate a refund of part of the purchase price of an item

references people who have known you and can provide information about your skills, character, and achievements

refinancing paying off an old loan by taking out a new loan, usually with better terms

reflation high prices followed by lower prices and then high prices again

rent-to-own agreement a contract in which a portion of the rent payment is applied toward the purchase price of the rented item

renter's insurance a tenant's policy that protects against the loss of personal property in a rented residence

repossession the act of taking an asset used as collateral and selling it to pay the debt

resume a summary of your work experience, education, skills, and interests that qualify you for a job opening

retirement a period of time, usually in later years, when you are not working but are able to meet expenses through other income sources

retirement plan an account into which employees contribute a portion of their earnings for their retirement; employers may match these contributions

return on investment (ROI) a measurement of return expressed as a percentage

revolving credit an account on which the account holder can charge repeatedly up to a maximum limit

risk the chance of injury, damage, or economic loss

risk assessment the process of identifying risks and deciding how serious they are

risk assumption accepting the consequences of risk

risk avoidance stopping behavior that leads to a risk

risk reduction finding ways to lower your chance of incurring a loss

risk transfer buying insurance to shift the risk of financial loss to an insurance company

rollover the process of moving a retirement account balance to another qualified account without incurring a tax penalty

roommate a person with whom you share living space and responsibilities

Roth IRA an individual retirement account in which contributions are taxed, but earnings are not

round lot exactly 100 shares or multiples of 100 shares of stock

Rule of 72 a quick formula for computing how long it will take to double money invested at a given interest rate

S

safe deposit box a secure container located in a bank vault

sales finance company a lender that makes loans for the purchase of consumer goods, often working closely with the seller

sales taxes taxes levied on consumer purchases of goods and services

Sarbanes-Oxley a law that set new and stronger standards for public companies and accounting firms regarding the reporting of financial results of operations

savings money set aside for the future

savings account a demand deposit account designed for the accumulation of money in a safe place for future use

scholarship a gift of money or other aid awarded to a student to help pay for education

secondary market the financial market in which previously issued securities are bought and sold

securities exchange a place where brokers buy and sell securities for their clients

Securities and Exchange Commission (SEC) primary overseer and regulator of the U.S. securities market

security deposit a refundable amount paid to cover damages to property caused by a tenant

self-insure setting aside money to be used in the event of injury or loss

self-training learning new skills from reading and practicing on your own

selling short selling stock that has been borrowed from a broker and replacing it at a later date

service credit the ability to receive services and pay for them later

shared responsibility an agreement between two or more people to bear a portion of an obligation

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

short-term goals things you expect to achieve within one week to one year

sick leave paid time away from work due to illness

simple interest interest computed on principal once during a certain time period

skill set the unique skills and abilities that you bring to the job market

smart card a card that contains a computer chip that stores electronic money

social network a group of friends and acquaintances who keep in contact and share information

social security tax a withholding tax to provide old-age, survivors, and disability insurance

soft skills nontechnical skills needed by most workers for success on the job

space-shifting copying the contents from one form of media to another for personal use

spending limit the maximum amount you are willing to pay for an item

spousal IRA an individual retirement account set up to benefit a spouse who has no income

spreadsheet software a computer program that allows you to insert numbers and formulas to compute amounts

stock ownership interest in a publicly held company

stock dividend a dividend paid in the form of new shares of stock

stock risk chance that activities or events affecting a company will change the value of an investment in that company

stock split the issuance of more stock to current shareholders in some proportion to the stock they already own

stock turning a strategy of making regular and systematic changes in stock ownership based on trends in the economy

stop-loss provision a clause that provides 100 percent coverage of medical expenses after a certain amount has been paid by the insured

stop order a request to sell a stock when it reaches a certain price

stop payment an instruction to the bank not to honor a check that has been issued or lost

store account a credit account that allows you to charge items or services only at that store or with that merchant

subsidized student loan a loan on which interest is not charged until the student graduates

supply the quantity of goods and services that producers are willing and able to provide

systematic decision making the process of making choices that reflect goals by considering all the pros and cons along with the costs

systematic investing a strategy that involves a planned approach to making investments on a regular basis

systematic saving a strategy that involves regularly setting aside cash that can be used to achieve goals

T

target audience a specific group of people who are likely to buy a product

tax deferral a postponement of taxes to be paid

tax-exempt not subject to taxation

temp agency an employment agency that provides part-time and full-time jobs on a temporary basis

term life insurance temporary insurance that pays only a death benefit and is in effect for a specific period of time

time-shifting recording video or audio for later viewing or listening

time value of money a concept that says a dollar you receive in the future will be worth less than a dollar you receive today

timeline a visual display of how long it will take to achieve each phase of a plan

trade-in something of value applied toward the down payment of a new purchase

tradeoff giving up one option in exchange for another

traditional IRA an individual retirement account that allows individuals to contribute pretax income to an account that grows tax-deferred

transfer payments money and benefits received from local, state, or federal governments

transit advertising print ads or signs appearing on public transportation

Truth-in-Lending Act a law requiring lenders to fully inform consumers about the cost of credit in a loan or credit agreement

tuition the expense paid by students for the instruction at a school

U

U.S. savings bond a discount bond issued by the federal government that pays a guaranteed minimum rate of interest

umbrella policy liability coverage above that of your homeowner's and car insurance

unearned income money received from sources other than working

uninsured/underinsured motorist coverage protection against damages caused by a motorist with no or insufficient insurance

unused credit the difference between your credit limit and your current balance

use taxes taxes based on the use of goods and services provided by the government

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

V

value a principle that reflects the worth you place on an idea or action

value-based pricing setting prices based on how much consumers are willing to pay

variable expenses costs that can go up and down each month

variable interest rate interest rate a lender can change at any time without notice

variances the differences between planned amounts and actual amounts

W

Wall Street Reform Act a law that is designed to create and maintain a stable financial system

wants things people desire for reasons beyond survival and basic comfort

warning label information on products advising consumers of risks and safety issues

wealth the accumulation of assets over your lifetime

withdrawal taking money from your account

workers' compensation an insurance plan that pays medical and disability benefits to workers injured on the job

Z

zero coupon bond a discount corporate bond that does not provide the typical semiannual interest payments

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Glosario

401(k) plan un impuesto diferido plan de jubilación que es financiado por los empleados de con fines de lucro de las empresas

403(b) plan un impuesto diferido plan de jubilación financiado por los empleados de gobierno y las organizaciones sin fines de lucro

A

comprobaciones de acceso controles establecidos por una compañía de tarjetas de crédito que le permiten pedir prestado contra su cuenta de tarjeta de crédito

préstamos con cargo adelantado un tipo de préstamo que incluye un pago por adelantado grandes

publicidad informar a los consumidores sobre los productos y animarles a comprar

resolución alternativa de conflictos (ADR) un método de solución de una controversia con un tercero neutral

cuota anual una cuota anual para su cuenta de afiliación

informe anual de una empresa informe a los accionistas sobre la situación financiera de la empresa

anualidad una cantidad fija a un lado de forma regular en el tiempo, un contrato de compra de una compañía de seguros que garantiza una serie de pagos mensuales durante un tiempo determinado

asignación de activos elegir una combinación de fondos dentro de una compañía de fondos mutuos sola activos dinero y objetos de valor que usted posee

subastados un mercado en el que una acción se vende al mejor postor

seguro de automóvil una política que protege a un propietario del vehículo de las pérdidas como consecuencia de accidentes y otros eventos

B

cebo y cambiar una técnica de venta ilegal en la que el negocio de publicidad de un producto de la negociación con la intención de persuadir a los consumidores a comprar un producto más caro

transferencia de saldo mover un saldo de una cuenta de tarjeta de crédito a otra

pago de globo un gran pago a tanto alzado que deben pagarse en un tiempo establecido

conciliación bancaria el proceso de ajustar el registro de la chequera y la declaración de los saldos bancarios a fin de que ellos están de acuerdo

quiebra un procedimiento legal para aliviar a una persona de una deuda excesiva

quiebra el fraude el abuso de las leyes de quiebra de una manera que favorece a los deudores y los acreedores defrauda

anuncios de la bandera anuncios en Internet que abarcan todo el superior, inferior, o en los lados de una página web

un mercado bajista período en el mercado de valores cuando los precios están en constante disminución

puntos de referencia las normas contra las cuales se mide el progreso

beneficiarios la persona designada para recibir dinero de un seguro de vida

beneficios las formas de pago que no sean sueldos o salarios

ciclo de facturación período de tiempo durante el cual usted debe hacer su pago mensual

de bonos un instrumento de deuda emitido por una corporación o un gobierno

cheque sin fondos un cheque que no es respaldado por un banco y se devuelve al banco del beneficiario, debido a la insuficiencia de fondos

estrategia de marca llevar los nombres de marca conocida para atraer a clientes que son leales a las marcas

presupuesto un plan de gastos y el ahorro sobre la base de los ingresos previstos y gastos

mercado alcista período en el mercado de valores cuando los precios están en constante aumento

ciclo del económico los períodos alternantes de crecimiento y declive de la economía

comprar y mantener un plan para comprar y mantener acciones en el largo plazo

comprar en el margen pidiendo dinero prestado a su agente de bolsa para comprar acciones

plan de compra un método organizado para la toma de buenas decisiones de compra

C

bonos redimibles un vínculo con una cláusula que permite al emisor para pagar la fianza a principios

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

cancelación de la tarifa una pena para el cierre de su cuenta antes de un período determinado

entradas de efectivo ingresos de su trabajo, inversiones y otras fuentes

salidas de efectivo gastos, o artículos para los que puede gastar el dinero

documento del degradar un cheque emitido contra los fondos del banco

certificado de depósito (CD) un depósito a plazo que paga una tasa fija de interés durante un período determinado de tiempo

Capítulo 7 de bancarrota la confiscación de los bienes de una persona a cambio de la aprobación de la gestión de las deudas

Capítulo 11 de bancarrota la reorganización de la deuda según lo decidido por el tribunal para que un negocio puede seguir siendo viable

Capítulo 13 de bancarrota un plan de pago de la deuda de los individuos

cargo a la tarjeta una forma de tarjeta de crédito que debe ser el saldo pagado en su totalidad cada mes

las donaciones caritativas el acto de donar tiempo o dinero a una causa en la que usted cree

check una orden por escrito a un banco a pagar una cantidad determinada a una persona o negocio

registro de cheques una herramienta que se utiliza para rastrear las transacciones de cuentas de cheques

cuenta de cheques un depósito a la vista en un banco en el que se dibujan los controles

cuenta de compensación una cuenta en la compra y venta de inversiones

garantía propiedad usada como garantía para un préstamo

coleccionables objetos raros, valiosos, tales como obras de arte, monedas, placas decorativas, libros y tarjetas de béisbol

la cobertura de colisión una política que protege contra los daños a su vehículo propio si chocó con otro coche o perder el control y darse la vuelta

comisión una tarifa fija o un porcentaje de una venta pagado a un empleado en lugar de o además del sueldo o salario

productos un elemento que tiene el mismo valor en el mercado con poca o ninguna diferencia de calidad entre los productores

Commodity Futures Trading Commission (CFTC) una agencia gubernamental que regula las materias primas, futuros y mercados de opciones

acciones comunes acción que paga dividendos variable y ofrece a los propietarios (accionistas) los derechos de voto

comparación de compras el proceso de control de los precios entre los vendedores de varias para asegurarse de que vas a encontrar el mejor precio para lo que compra

interés compuesto los intereses devengados por tanto el principal como los intereses devengados con anterioridad

una amplia cobertura protección contra daños a su vehículo por causas distintas de colisión o vuelco

examen algo de valor intercambiado por algo más de valor

de defensa del consumidor proceso de ayudar a los consumidores a resolver problemas

sociedad financiera de consumo un prestamista que generalmente se extiende préstamos de alto interés para los consumidores que pueden ser elegibles para otros tipos de préstamos

créditos de consumo un préstamo directo de dinero en efectivo realizados a un consumidor a una tasa de interés fija durante un período determinado de tiempo

en contacto con una persona que conoces, como un pariente o amigo

contingencias imprevistas o posibles eventos

contrato un acuerdo legalmente vinculante que especifica los derechos y deberes de cada parte

bonos convertibles un vínculo que puede ser canjeado por acciones ordinarias a opción del tenedor de bonos

precio de coste incrementado establecimiento de un precio basado en el costo de producción más margen

impulsada por el costo de inflación aumento de los precios como consecuencia de los costes de producción crecientes

recuperación de los costos de fijación de precios el establecimiento de un precio de lanzamiento de alta para recuperar los costes de R&D

tasa de cupón la tasa de interés fija que se paga semestralmente por la vida de un bono

carta de presentación una carta que acompaña a una hoja de vida, al presentar el solicitante a un posible empleador

crédito de la capacidad de pedir dinero prestado y pagar de nuevo más tarde

tarjetas de crédito tarjeta de plástico vinculados a una cuenta de crédito que se puede utilizar para hacer compras

Tarjeta de Crédito Ley de 2009 una reforma integral a la ley de tarjetas de crédito para establecer prácticas justas con relación al crédito

fraude con tarjetas de crédito intencionalmente la cuenta de alguien de crédito para robar dinero o bienes

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

de asesoría de crédito servicio para ayudar a los consumidores gestionar el crédito y evitar la quiebra

crédito de la delincuencia falta de pago de deudas como exige el acuerdo o por la ley

acreditación de servicios de protección un plan que ofrece monitoreo de crédito por una cuota

de reparación de crédito una estafa en la que una empresa dice ser capaz de "arreglar" su historial de crédito pobre y le da un historial de crédito limpio

criterios normas o reglas por las que algo se juzga

programa de fidelización de clientes un programa diseñado para fomentar la actividad de un cliente repita ofreciendo descuentos y otros incentivos

D

tarjeta de débito una tarjeta para retirar o deducir dinero de su cuenta de cheques

de consolidación de deudas el proceso de obtener un préstamo con un pago único mensual para pagar todas sus deudas

plan de pago de la deuda una estrategia para el pago de la deuda de una manera que reduce el total de intereses pagados

engaño afirmaciones falsas o engañosas hechas acerca de la calidad, precio, o el propósito de un producto

deflación disminución en el nivel general de precios de los bienes y servicios

la demanda la voluntad y la capacidad de los consumidores para comprar bienes y servicios

impulsada por la demanda de inflación aumento de los precios como resultado de los consumidores que deseen comprar más bienes y servicios que los productores de suministro

dependientes una persona que depende de ti más de la mitad de su apoyo

depósito dinero añadido a una cuenta corriente o cuenta de ahorros

la publicidad directa distribución de información sobre el producto directamente a los consumidores

la inversión directa compra de acciones y otras inversiones directamente en las empresas y la celebración de los

seguro por invalidez seguro que proporciona ingresos para reemplazar una porción de las ganancias normales cuando el asegurado no puede trabajar debido a una lesión no laboral o enfermedad relacionada con

aprobación de la gestión una orden judicial que perdona al deudor del pago de deudas

descuento de bonos un bono que se vende por menos de su valor nominal

corredor de descuento un corredor de bolsa cualificado que compra y vende valores a una comisión reducida, pero no ofrece asesoramiento

los descuentos de precios que ofrece el precio más bajo posible, todos los días

Para discrecional una orden de compra (o venta) una acción que permite al agente para obtener el mejor precio posible

desinflación aumento de los precios con la tasa de aumento de desaceleración

la renta disponible dinero disponible para gastar o ahorrar después de impuestos han sido pagados

diferencia carta una carta para informar a una empresa de crédito de una carga incorrecta en su cuenta

disputar un cargo el proceso de informar a una empresa de crédito de un error en su factura

la diversificación la celebración de una variedad de inversiones con el fin de reducir el riesgo global

dividendos una porción de las ganancias de una empresa distribuida a los accionistas

documentación registros que apoyan su reclamo

dólar de costo promedio invertir la misma cantidad de dinero sobre una base regular, independientemente de las condiciones del mercado

pago por epósito en efectivo al precio de compra

E

penalidad por retiro anticipado imposición de una tasa para disuadir a los depositantes de retirar el dinero antes del plazo establecido

acceso al crédito fácil tipos de crédito que se puede obtener de forma rápida y sencilla, pero a menudo vienen con altos costos y ocultos

economizar horro de la medida de lo posible el dinero y el gasto sólo cuando sea necesario

economía todas las actividades relacionadas con la fabricación y distribución de bienes y servicios en un área geográfica o país

transferencia electrónica de fondos el uso de un sistema basado en computadora para mover el dinero de la cuenta del librador en la cuenta del beneficiario

registros electrónicos formatos electrónicos de su información financiera almacenada en su ordenador

fondo de emergencia dinero reservado para gastos imprevistos

compra emocional proceso de compra de los productos basados en el deseo en lugar de la lógica

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

cifrado proceso de conversión de datos a una forma codificada

respaldo una firma, con o sin instrucciones por escrito en el reverso de un cheque

empresario una persona que asume los riesgos de ser trabajadores por cuenta propia y ser dueño de un negocio

Crédito Ley de Igualdad de Oportunidades una ley que protege a los consumidores contra la discriminación en la concesión o denegación del crédito

los fondos propios una segunda hipoteca o deuda garantizada con el valor de su casa

despojo la práctica ética de extender un préstamo a un propietario de vivienda en dificultades que no pueden pagar los pagos del préstamo, lo que el prestamista toma posesión de la casa

bienes todo lo que una persona posee (activos), menos las deudas, en el momento de la muerte de esa persona

la ética un conjunto de valores morales que la gente considera aceptable; el estudio de lo que es correcto contra lo incorrecto

desalojo el proceso de expulsar a un inquilino de la propiedad alquilada

los impuestos especiales cuotas soportadas en la adquisición de bienes y servicios específicos

exención una persona como dependiente en una declaración de impuestos, la propiedad de que un deudor en quiebra no tiene por qué renunciar a pagar a los acreedores

garantía extendida cobertura adicional que usted puede comprar para pagar las reparaciones o sustituciones necesarias más allá del período de garantía original

F

Justo de Crédito Ley de Facturación una ley que establece los requisitos para la resolución de disputas de facturación

Informe Justo de Crédito Ley una ley que le otorga el derecho a saber lo que hay en su archivo de crédito

Prácticas Justas de Cobro de Deudas una ley que protege a los consumidores de prácticas abusivas de los acreedores y agencias de cobro

pago-por-servicio del plan un tipo de plan de seguro médico que permite al paciente elegir a los proveedores médicos (cuidado administrado)

ayuda financiera dinero que recibe de una fuente externa para ayudar a pagar por la educación

metas financieras planes de cómo van a pagar por sus metas personales

Autoridad Reguladora de la Industria Financiera (FINRA) una organización privada, sin fines de lucro que regula las empresas de venta de valores en los Estados Unidos

irresponsabilidad financiera no a la altura de sus obligaciones financieras para cumplir con sus objetivos y necesidades

los mercados financieros un lugar donde las inversiones se compran y venden

plan financiero un plan de lista de metas personales y financieras, junto con las medidas y una línea de tiempo para llegar a ellos

planificador financiero un asesor profesional que ofrece asesoramiento financiero a una tarifa o comisión

recursos financieros dinero u otros objetos de valor que se utilizan para adquirir bienes y servicios

responsabilidad financiera ser capaz de alcanzar sus metas financieras a través de ingresos previsto, el gasto y el ahorro

seguridad financiera la capacidad para satisfacer las necesidades actuales y futuras, viviendo cómodamente

opciones de financiamiento maneras de pagar por un concepto que con dinero en efectivo

gastos fijos costos que no cambian cada mes

tasa de interés fija las tasas de interés que no cambia de mes a mes

flotante de un cheque escribir un cheque y la planificación para hacer un depósito después de cubrirlo antes de que el cheque es procesado

seguimiento contacto con un posible empleador después de la entrevista, pero antes de que una persona es contratada para la apertura

juicio hipotecario el proceso legal de la toma de posesión de una casa (propiedad) cuando un prestatario no hace pagos de la hipoteca tal como se acordó

Formulario 1040EZ el impuesto a corto formulario de devolución diseñado para contribuyentes individuales y conjuntos sin dependientes o las deducciones detalladas

Forma W-2 un formulario que se utiliza para reportar el ingreso imponible de un trabajador recibió durante el año natural

fundación un fondo o una organización establecida y mantenida con el propósito de apoyar a una institución o una causa

franquicia un contrato que le da el derecho a vender productos de una compañía y servicios

servicio completo de broker un corredor de bolsa cualificado que proporciona asesoramiento sobre qué valores para comprar y vender

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

contrato de futuros un acuerdo para comprar o vender un producto básico específico o moneda a un precio determinado en una fecha determinada en el futuro

G

Embargo un proceso legal que permite que parte del sueldo de un empleado que se retendrá para el pago de una deuda

Joyas piedras naturales, piedras preciosas como diamantes, rubíes, zafiros y esmeraldas

Objetivo un resultado deseado sobre la base de sus propios valores para que se aplique un plan de acción a

Período de gracia la cantidad de tiempo que tiene que pagar su factura de tarjeta de crédito sin tener que pagar intereses sobre sus compras de nuevos

subvención dinero recibido para pagar los gastos educativos que no tienen que ser reembolsados

salario bruto total del sueldo o salarios devengados durante el período de pago

H

habilidades duras mensurables capacidades físicas y mentales que le permiten terminar un trabajo

Head-hunter un especialista en el empleo que busca a personas altamente cualificadas para ocupar puestos de nivel superior para un empleador

seguro de salud un plan para compartir el riesgo de los gastos médicos de una lesión o enfermedad

Organización de mantenimiento de salud (HMO) un plan de grupo que provee atención médica de prepago para sus miembros

casa de inventario una lista de elementos de valor en su hogar, un seguro de

dueño de casa de seguros una política que protege contra el riesgo de pérdida a una casa y su contenido

hiperinflación rápido aumento de los precios que están fuera de control

I

robo de identidad el uso de su información personal de otra persona para cometer fraude u otros delitos

ilíquidos no convertibles en dinero de manera rápida y sin una sanción

impulso comprar algo de compra en el impulso del momento sin ningún tipo de planificación

pagos en efectivo dinero en forma de cheque, tarjeta de débito o pago directo, a una persona que necesita ayuda

pagos en especie los pagos efectuados indirectamente en nombre de una persona o en una forma que no sea dinero

cuenta inactiva una cuenta corriente o cuenta de ahorros que no cumple los requisitos mínimos de uso

inversión indirecta compra de acciones de un fondo mutuo en lugar de comprar las acciones individuales de las acciones en varias empresas

riesgo en industria posibilidad de que los factores que afectan a un industria en su conjunto afectará negativamente el valor de una inversión

la inflación aumento en el nivel general de precios de los bienes y servicios

riesgo de inflación posibilidad de que la tasa de inflación será más alta que la tasa de rendimiento de inversión

infomercial un largo anuncio de televisión para abonados, que incluye testimonios, demostraciones, y los precios de introducción

Plazo de crédito de crédito utilizada para financiar un único elemento de alto precio a través de una serie de pagos iguales efectuados durante un período determinado de tiempo

interés el dinero ganado en las cuentas de ahorro y otros fondos

banca por Internet acceso y gestión de su cuenta en línea

tasa introductoria una tasa de interés bajas temporales ofrecidos al abrir una nueva cuenta

invertir una estrategia para ganar más en el dinero que la tasa de inflación

Club de Inversión un grupo de personas que reúnen su dinero para comprar y vender inversiones

inversión de cartera un conjunto de activos que ofrece la diversificación para el inversor

inversión de riesgo potencial para el cambio en el valor de una inversión

seguimiento de la inversión técnica para hacer opciones de inversión, siguiendo los precios de acciones en el tiempo

J

solicitud de empleo una forma que hace preguntas básicas sobre los antecedentes del solicitante, tales como historial de trabajo, educación, habilidades, y las referencias

descripción del puesto describe lo que un trabajo sería, incluidas las tareas realizadas y las habilidades necesarias

entrevista de trabajo una reunión cara a cara con un empleador potencial para discutir una oferta de trabajo

mercado de trabajo las ofertas de trabajo que están disponibles cuando usted está listo para ir a trabajar

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

observación de profesionales pasar el tiempo observando a un trabajador en un tipo de trabajo que le interesa

K

Keogh cuenta una jubilación con impuestos diferidos plan para los profesionales por cuenta propia

L

contrato de arrendamiento un contrato de alquiler que especifica los derechos y obligaciones del arrendador y el arrendatario

pasivos las deudas que usted debe

cobertura de responsabilidad protección contra las lesiones sufridas por otras personas en su propiedad o como resultado de sus acciones

seguro de vida seguro que paga el dinero al beneficiario en caso de fallecimiento del asegurado

límite para una solicitud para comprar (o vender) un stock a un precio determinado

línea de crédito un préstamo preaprobado cantidad que el deudor puede pedir prestado en contra, pagar y pedir prestado de nuevo, según sea necesario

liquidez una medida de la rapidez de un activo puede ser convertido en dinero en efectivo

hábitos de vida su rutina diaria, o la forma que elija para vivir su vida

de modificación de préstamos un acuerdo de préstamo que le permite hacer pagos reducidos, generalmente de forma temporal

préstamo de tiburón una persona que ofrece préstamos sin garantía ilegales en las tasas de interés muy altas

logística el acto de hacer un plan y llevarlo a cabo para garantizar un evento se lleva a cabo

objetivos a largo plazo cosas que esperan alcanzar más de cinco años a partir de ahora

la pérdida de una lesión física, daños a la propiedad, o la desaparición de la propiedad

bajo bolas publicidad de un servicio básico a un precio inusualmente bajo y luego reclamar las reparaciones o servicios adicionales se necesitan

M

registros manuales información registrada con pluma y papel

fijación de precios basado en el mercado fijación de precios para ser competitivos con los precios de productos similares que se venden actualmente

economía de mercado una economía basada en las leyes de la oferta y la demanda

mercado para una solicitud para comprar (o vender) un stock a precio de mercado actual

horarios de los mercados compra y venta de acciones sobre la base de lo que el mercado se espera que haga

valor de mercado el precio más alto Propiedad traerá en el mercado abierto

marcado la cantidad del porcentaje añadido al coste de producción para obtener el precio de un artículo

madurez valor valor futuro de un bono como se indica en su cara

Impuestos de Medicare un impuesto que paga por el cuidado médico para los jubilados

objetivos a medio plazo que esperan alcanzar en los próximos dos a cinco años

pago mínimo la cantidad que deben pagar cada mes en una cuenta de crédito

salario mínimo la menor tasa de pago permitido por la ley para cada hora de trabajo ordinario

cuenta del mercado monetario un tipo de cuenta de ahorros que gana la tasa de interés de mercado sobre el dinero depositado

giro postal un tipo de control utilizado para pagar cuentas o hacer pagos por los que se garantiza el dinero

hipoteca una deuda a largo plazo un acuerdo para la adquisición de inmuebles

fondos de inversión un grupo de gestión profesional de inversiones compraron uso de una reserva de dinero de muchos inversores

N

Nacional de Crédito Union Administration (NCUA) una agencia federal independiente que supervisa las cartas y las cooperativas de crédito

necesidades cosas necesarias para la supervivencia, como alimentos, ropa, vivienda y atención médica

pagar el importe neto de su sueldo después de las deducciones

patrimonio neto la diferencia entre sus activos y sus pasivos

beneficio normal un beneficio que permite a una empresa para sobrevivir y crecer needs

O

Odd Lot menos de 100 acciones de

Oficina del Contralor de la Moneda (OCC) una agencia gubernamental dedicada a asegurar un sistema nacional bancario sano y salvo

Oficina de Supervisión de Ahorro (OTS) una agencia gubernamental que provee supervisión del ahorro (ahorro y préstamo) instituciones

en el puesto de trabajo formación y aprendizaje como lo hace el trabajo

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

oportunidad costo el valor de su siguiente mejor opción-lo que se dan por vencidos

la optimización de obtener el mayor valor por el dinero gastado

sin receta (OTC) una red de distribuidores e intermediarios que compran y venden acciones y otros valores que no figuran con una bolsa de valores

sobre el límite de pago- una pena de carga cuando se excede su límite de crédito aprobado

de protección contra sobregiros un servicio bancario que cubre un déficit en su cuenta

supervisión la supervisión de un organismo regulador de las actividades para garantizar que los derechos de los inversionistas están protegidos

pago de horas extras salario percibido por las horas trabajadas además de las horas regulares

P

pena una tasa percibida por la violación de un término del contrato de crédito

Beneficios de Pensiones Guaranty Corporation (PBGC) una corporación federal, cuyo principal propósito es proteger los ingresos de jubilación de los trabajadores con pensiones de prestaciones definidas, los planes de

seguro de vida permanente una política que prevé un beneficio por fallecimiento y acumula valor en efectivo

metas personales cosas que quieres lograr en tu vida

protección contra lesiones personales (PIP) la cobertura de asistencia médica, hospitalaria y los costos del funeral del asegurado y de los pasajeros en caso de un accidente de auto

licencia personal tiempo pagado fuera del trabajo por razones personales

suplantación de identidad una estafa en la que se envía un correo electrónico de alguien haciéndose pasar por su banco o negocio legítimo que le pedían su información personal

paloma caída una estafa en la que un estafador convence a una persona a dejar su dinero a cambio de una cuota de una cantidad mayor de dinero

el riesgo político posibilidad de que un acontecimiento político afectará el valor de una inversión

Ponzi régimen una operación de inversiones fraudulentas en las que el dinero recaudado de nuevos inversionistas se utiliza para pagar a los inversionistas anteriores

anuncios pop-up anuncios de Internet que abren una nueva ventana que aparece en la pantalla delante de la página web que se visualiza

cheque con fecha adelantada un cheque por escrito con una fecha que se producirán en el futuro

aprobación previa del préstamo un préstamo para el que se establece una cantidad máxima y aprobada de antemano

metales preciosos metales raros, que suelen ser sustancias naturales, que han conocido el valor de todo el mundo

organización de proveedores preferidos (PPO) una red independiente de profesionales de la salud que trabajan juntos para proporcionar servicios de salud

acciones preferentes acción que garantiza un dividendo fijo, pero no proporciona derechos de voto

prima el precio que paga por la cobertura del seguro

prima de bonos un bono que se vende por más de su valor nominal

multa por pago anticipado una tasa de paga si usted pagar el préstamo antes de la hora acordada

mercado primario el mercado financiero en el que las nuevas emisiones de valores se venden

principales suma de dinero a un lado en el que se pagan los intereses

probabilidad la probabilidad de un riesgo que resulta en una pérdida

la productividad una medida de la eficiencia con la que bienes y servicios se hacen (comparación de la producción total de los insumos totales)

plan de participación en los beneficios un beneficio por el cual los empleados pueden participar en los beneficios de la empresa

administrador de la propiedad una persona contratada para cuidar de alquiler y para comunicarse con los inquilinos en nombre del propietario

impuestos a la propiedad los impuestos sobre la riqueza basada en el valor tasado de la propiedad inmobiliaria

los bienes públicos proporcionado por el Gobierno los bienes y servicios pagados por los impuestos

esquema de la pirámide un truco de marketing multinivel ilegal que las promesas de comisiones en una de las ventas propia, así como en las ventas de los reclutas

R

compra racional proceso de selección de bienes y servicios basados en las necesidades, desea, y opciones lógicas

coste real de inflación aumento de los precios debido a la escasez de recursos o una mayor dificultad en la obtención de recursos

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

descuento un reembolso de una parte del precio de compra de un artículo

referencias las personas que ha conocido y puede proporcionar información acerca de sus habilidades, carácter y logros

refinanciación el pago de un préstamo de edad mediante la adopción de un nuevo préstamo, por lo general con mejores condiciones

reflación los altos precios seguida por los precios más bajos y los altos precios del nuevo

contrato de alquiler con opción a compra un contrato en que se aplica una parte del pago del alquiler al precio de compra del artículo alquilado

arrendatario de seguros un inquilino de la política que protege contra la pérdida de propiedad personal en una residencia alquilada

recuperación el acto de tomar un activo como garantía y venderlo para pagar la deuda

curriculum vitae un resumen de su experiencia laboral, educación, habilidades, e intereses que usted califica para una oferta de trabajo

jubilación un período de tiempo, por lo general en los últimos años, cuando no están trabajando, pero son capaces de cumplir con los gastos a través de otras fuentes de ingresos

plan de jubilación una cuenta en la que los empleados contribuyen con una porción de sus ingresos para su jubilación, los empleadores pueden coincidir con estas contribuciones

retorno de la inversión (ROI) una medida de rendimiento expresado en porcentaje

crédito rotativo una cuenta en la que el titular de la cuenta puede cargar varias veces, hasta un límite máximo

crédito rotativo una cuenta en la que el titular de la cuenta puede cargar varias veces, hasta un límite máximo

riesgo la posibilidad de lesiones, daños o pérdidas económicas

evaluación de riesgos el proceso de identificación de los riesgos y decidir su gravedad

la asunción de riesgos aceptar las consecuencias de riesgo

prevención de riesgos detener el comportamiento que conduce a un riesgo

la reducción del riesgo encontrar maneras de reducir la probabilidad de incurrir en una pérdida

transferencia de riesgos comprar un seguro de cambio el riesgo de pérdida financiera de una compañía de seguros

rollover el proceso de traslado de un saldo de la cuenta a otra cuenta de jubilación calificado, sin incurrir en una sanción fiscal

compañero de cuarto una persona con quien se comparte el espacio vital y responsabilidades

Roth IRA una cuenta de retiro individual en el que se gravan las contribuciones, pero las ganancias no son

todo el lote exactamente 100 acciones o múltiplos de 100 acciones de

Regla del 72 una fórmula rápida para calcular cuánto tiempo le tomará duplicar el dinero invertido en un tipo de interés determinado

S

caja de seguridad un contenedor de seguridad situado en una bóveda de un banco

ventas de la compañía finanzas un prestamista que otorga préstamos para la compra de bienes de consumo, a menudo trabajando estrechamente con el vendedor

impuestos sobre las ventas impuestos sobre las compras de los consumidores de bienes y servicios

Sarbanes-Oxley una ley que establece las normas nuevas y más fuertes para las empresas públicas y las empresas de contabilidad en relación con la comunicación de los resultados financieros de las operaciones

ahorro dinero reservado para el futuro

cuenta de ahorros un depósito en cuenta la demanda diseñado para la acumulación de dinero en un lugar seguro para uso futuro

becas un regalo de dinero u otra ayuda otorgada a un estudiante para ayudar a pagar por la educación

mercado secundario el mercado financiero en el que previamente emitido valores se compran y venden

canje de valores un lugar donde los agentes de compra y venta de valores para sus clientes

Comisión de Valores y Bolsa (SEC) supervisor principal y el regulador del mercado de valores de EE.UU.

depósito de seguridad una cantidad reembolsable destinada a cubrir los daños materiales causados por un inquilino

autoasegurarse dejando de lado el dinero que se utilizará en caso de daño o pérdida

autoformación aprender nuevas habilidades de la lectura y practicar por su cuenta

ventas en corto venta de acciones que ha tomado prestado de un corredor y lo sustituya en el futuro

servicio de crédito la capacidad de recibir los servicios y pagar por ellos más tarde

responsabilidad compartida un acuerdo entre dos o más personas para llevar una porción de una obligación

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

metas a corto plazo cosas que esperan alcanzar dentro de una semana a un año

baja por enfermedad tiempo pagado fuera del trabajo debido a una enfermedad

interés simple interés calculado sobre el principal una vez durante un cierto período de tiempo

conjunto de habilidades las destrezas y habilidades únicas que le traen al mercado de trabajo

tarjeta inteligente una tarjeta que contiene un chip de computadora que almacena dinero electrónico

redes sociales un grupo de amigos y conocidos que tenga en la información de contacto y compartir

contribución al seguro social una retención en origen para proveer de vejez, sobrevivientes e invalidez

habilidades blandas habilidades no técnicas que necesitan la mayoría de los trabajadores para el éxito en el trabajo

el cambio de espacio copiar el contenido de un medio de comunicación a otro para uso personal

límite de gastos el importe máximo que está dispuesto a pagar por un artículo

IRA conyugal una cuenta de retiro individual creado para beneficiar a un cónyuge que no tiene ingresos

de hojas de cálculo un programa de ordenador que te permite insertar números y fórmulas para calcular cantidades

acciones propiedad de interés en una compañía que cotiza en bolsa

acciones dividendo a los dividendos percibidos en forma de nuevas acciones

riesgo de existencia posibilidad de que las actividades o eventos que afectan a una empresa va a cambiar el valor de una inversión en la empresa

desdoblamiento de acciones la emisión de más acciones a los actuales accionistas en una proporción de la población que ya poseen

acciones inflexión una estrategia de hacer cambios regulares y sistemáticas en la titularidad de acciones basadas en las tendencias de la economía

detener la pérdida de la prestación una cláusula que establece una cobertura del 100 por ciento de los gastos médicos después de una cierta cantidad ha sido pagada por el asegurado

Para dejar de una solicitud para vender una acción cuando se alcanza un determinado precio

detener el pago una instrucción para que el banco no para honrar a un cheque que ha sido emitido o se pierde

cuenta de la tienda una cuenta de crédito que le permite cargar artículos o servicios sólo en esa tienda o con ese comerciante

préstamos estudiantiles subsidiados un préstamo en el que no se cobran intereses hasta que el estudiante se gradúe

suministro de la cantidad de bienes y servicios que los productores están dispuestos y son capaces de proporcionar

la decisión la toma sistemática el proceso de tomar decisiones que reflejen los objetivos al considerar todos los pros y los contras, junto con los costes

inversión sistemática una estrategia que implica un enfoque planificado para la realización de inversiones sobre una base regular

ahorro sistemático una estrategia que consiste en regular la anulación de efectivo que puede ser aprovechada para alcanzar metas economy

T

objetivo público un grupo específico de personas que están propensos a comprar un producto

aplazamiento de impuestos el aplazamiento de los impuestos a pagar

exenta de impuestos que no están sujetos a impuestos

agencia temp una agencia de empleo que proporciona a tiempo parcial y el empleo a tiempo completo con carácter temporal

seguro de vida temporal seguro temporal que sólo paga un beneficio por fallecimiento y se encuentra en vigor por un período específico de tiempo

cambio de tiempo grabación de vídeo o de audio para su posterior visualización o escucha

tiempo de valor del dinero un concepto que dice que un dólar que recibamos en el futuro tendrá un valor de menos de un dólar que recibe hoy línea de tiempo una representación visual de cuánto tiempo se necesitará para alcanzar cada fase de un plan

el comercio en compensación renunciar a una de las opciones a cambio de otro

IRA tradicional una cuenta de retiro individual que permite a los individuos para contribuir ingresos antes de impuestos a una cuenta que crece con impuestos diferidos

pagos de transferencia dinero y beneficios recibidos de locales, estatales, federales o de los gobiernos

tránsito de publicidad anuncios impresos o signos que aparecen en el transporte público

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Verdad en Préstamos Ley una ley que exige a los prestamistas a informar plenamente a los consumidores sobre el costo del crédito en un contrato de préstamo o crédito

matrícula los gastos pagados por los estudiantes para la instrucción en una escuela

U

Bonos de Ahorro de los EE.UU. un bono de descuento emitidos por el gobierno federal que paga un tipo de interés mínimo garantizado

Paraguas de la política cobertura de responsabilidad por encima de la de su propietario y el seguro de coche

Ingresos no ganados dinero recibido de otras fuentes de trabajo

Sin seguro o la cobertura de motorista con seguro insuficiente protección contra daños causados por un conductor sin o con seguro insuficiente

crédito no utilizadas la diferencia entre el límite de crédito y el saldo actual

Utilizar los impuestos los impuestos sobre el uso de bienes y servicios proporcionados por el gobierno

V

Valor un principio que refleja el valor se coloca en una idea o acción

fijación de precios basada en el valor fijación de precios basado en cómo los consumidores tanto están dispuestos a pagar

Los gastos variables costos que pueden subir y bajar cada mes

Tipo de interés variable los tipos de interés un prestamista puede cambiar en cualquier momento sin previo aviso

Las variaciones las diferencias entre las cantidades previstas y las cantidades reales

W

Wall Street Ley de Reforma una ley que está diseñada para crear y mantener un sistema financiero estable

quiere cosas que la gente desea, por razones más allá de la comodidad y la supervivencia básica

advertencia en la etiqueta información sobre los productos recomienda a los consumidores de los riesgos y problemas de seguridad

la riqueza la acumulación de activos durante su vida

retirada tomar dinero de su cuenta

compensación de los trabajadores un plan de seguro que paga las prestaciones médicas y la discapacidad a los trabajadores lesionados en el trabajo

Z

cero bono cupón un bono de descuento corporativo que no ofrece la típica pagos semestrales de interés

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Index

A

ABA. *See* American Banking Association (ABA)
Access checks, 241
Actual cash value, 207
Adjustable-rate mortgage (ARM), 260
Adjusted balance method, 238
ADR. *See* Alternative dispute resolution (ADR)
Advance-fee loan, 271
Advertising
  direct, 95, 96
  explanation of, 94
  transit, 96
  types of, 94–96
Agriculture career, 406
Airline Passenger Rights, 101–102
Alternative dispute resolution (ADR), 302
American Banking Association (ABA), 154
American Stock Exchange (AMEX), 384
AMEX. *See* American Stock Exchange (AMEX)
Amortization, 258
Angel investors, 367
Annual fee, 268
Annual percentage rate (APR), 241. *See also* Credit cards, interest rates for
Annual report, 378
AnnualCreditReport.com, 298
Annuity, 165–166, 351
Application letter. *See* Cover letter
Appreciation, of assets, 120, 259
APR. *See* Annual percentage rate (APR)
Arbitration, 302
Architecture careers, 308
ARM. *See* Adjustable-rate mortgage (ARM)
Assessed value, defined, 56
Asset allocation, 355
  in mutual funds, 356
Assets, 119
  appreciation, 120, 259
  defined, 16
  depreciation, 120, 368
Associate's degree, from community colleges, 14–15
Association of Independent Consumer Credit Counseling Agencies, 292
ATM. *See* Automated teller machine (ATM)
ATM cards, 153
ATM fees, 176
Auction market, 384
Automated teller machine (ATM), 151, 173
Automatic deposit, 155
Automatic payment, 211
Automatic stay, 292
Automatic withdrawals, 151–152, 271
Automobile insurance, 208–209
  coverage of, 208–209
  explanation of, 208
  no-fault insurance laws, 209
Average daily balance method, 238–239

B

Bachelor's degree, 14, 16
Bad news message, 351
Bait and switch, 106
Balance transfer, 241
Balloon payment, 263
Bank cards, 174–175
Bank reconciliation, 156–158
Bankruptcy
  Chapter 7, 292–293
  Chapter 11, 293, 294
  Chapter 13, 294, 295
  explanation of, 290
  involuntary, 290
  methods to avoid, 291–292
  purposes of, 290–291
  voluntary, 290
Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), 295
Bankruptcy fraud, 295
Banks. *See also* Money management
  bank cards offered by, 174–175
  career in, 181
  checking account offered by, 149–159
  defined, 149
  Internet access offered by, 174
  savings options offered by, 162–169
  services and fees of, 172–178
Bank statements
  explanation of, 156
  method for reconciling, 156–158
Banner ads, on Internet, 95
BAPCPA. *See* Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)
Barron's, 378
Basic health care, 196
BBB. *See* Better Business Bureau (BBB)
Bear market, 336
Benchmarks, 137
Beneficiary, 199
Benefits, 45. *See also* Employee benefits
  educational, 46
Better Business Bureau (BBB), 105
Billboards, 95
Billing cycle, 267
Bing, 379
Blank endorsement, 154
Bonds, 347–351
  callable, 349
  convertible, 349
  corporate, 348–349
  discount, 347
  explanation of, 325
  government, 349–350
  investment-grade, 349
  municipal, 351
  premium, 348
  ratings, 349
  savings. *See* Savings bonds
  speculative-grade, 349
  zero coupon, 349
Bounced check, 175
Branding strategy, defined, 94
Breach, of contract, 254
Brochures, 95
Brokerage accounts, 347
  setting up, 389
Brokerage firms, 169
BrokerCheck, FINRA, 383
Brokers, 381
  discount, 381–382, 393
  full-service, 381, 382
  online, 382
Budget
  analysis of, 129–130
  explanation of, 125
  group, 251, 252
  method for building, 126–128
Bull market, 335–336
Bureau of Consumer Protection, 283
Bureau of Labor Statistics, 78
Business
  advantages of owing a, 42
  disadvantages of owing a, 42
  getting started in, 43–44
  plan, explanation of, 44
  types of, 42–43
Business cycle, 12–13
Business ownership
  investments in, 366–367
Business personal property tax, 56
Business plans, 366
Business startup, 261
Business venture, 367
BusinessWeek, 377
Buy and hold, 392
Buyer's remorse, 122, 222
  emotional and impulse buying and, 89
Buying
  plan for. *See* Buying plan
Buying decisions
  decision-making process, 121–122
  strategies, 122
Buying Guide, 105
Buying on margin, 392
Buying patterns, 392
  buy and hold, 392
  stock turning, 393
  watch and wait, 393
Buying plan, 222–225
  creating, 222–223
  designing, 220–225
  implementing, 223–225
Buying strategies
  after shopping, 97
  consumers for, 97–98
  economizing as, 89
  optimizing as, 89, 90
  on prices, 88–90
  before shopping, 97
  while shopping, 97
Buyout timing, stocks, 394
Bylaws, 15

C

Cafeteria plan, 45
Callable bond, 349
Call-a-nurse programs, 195
Canceled checks, 149, 158
Cancellation fee, 240
Capital gains tax, 356
Car, buying plan, 316, 318
Car-buying services, 173

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Car lease, 259
Car loan, 258
Care Labeling Rule of 1971, 103
Care labels, 103
Career exploration
in agriculture, 406
in architecture, 308
in banking, 181
in credit, 245
in education, 113
in information technology, 372
in insurance, 215
in journalism, 34
in law enforcement, 275
in manufacturing, 143
in marketing, 339
in tax collection, 72
Career schools, 15
Careers. *See also* Occupations
costs of education and training for, 13–16
education needed for, 7–8
values and goals in choice of, 6
Cash, for investments, 391
Cash advance, 232
fees, 269
Cash dividend payment, defined, 51
Cash flow
actual, 125
negative, 368
positive, 368
Cash inflows, 119
Cash outflows, 119
Cashier's check, 173
Catastrophic illness, 196
CD. *See* Certificate of deposit (CD)
Certificate of deposit (CD), 163, 167, 345–346
Certified financial planner (CFP), 138, 383
CFP. *See* Certified financial planner (CFP)
CFPA. *See* Consumer Financial Protection Agency (CFPA)
CFTC. *See* Commodity Futures Trading Commission (CFTC)
Chapter 7 bankruptcy, 292–293
Chapter 11 bankruptcy, 293, 294
Chapter 13 bankruptcy, 294, 295
Charge card, 229
Charitable giving, 128
Check fraud, 153
Checkbook register, 150–151
Checking accounts
explanation of, 149–150
fees and rules for, 159
keeping a checkbook register for, 150–151
making deposits to, 153–155
method for opening, 150
services available with, 151–153
statements for, 156–159
Checks
bounced, 175
canceled, 149, 158
cashier's, 173
cleared, 158
endorsements, 154–155
explanation of, 149, 150
outstanding, 158
postdated, 152
procedure for writing, 152–153
third-party, 155
traveler's, 173
truncated, 158–159
Choices
based on available resources, 118–119
based on values and goals, 6
education, 7–8
financial strategies, 122
job, affecting income, 4–6
making good financial, 121–122
Cigarette Labeling and Advertising Act of 1965, 103
Circulars, for advertising, 95
Class action lawsuit, 303
Clearance sale, meaning of, 109
Cleared checks, 158
Clearing account, 347
Closing costs, 260
COLA. *See* Cost-of-living adjustments (COLA)
Collateral, 230, 286
Collectibles, as investments, 369
Collection agencies, 285
Colleges/universities
advanced degrees and programs in, 15–16
earnings of graduates of, 14
public *vs.* private, 14–15
Collision coverage, 208–209
Commissions
explanation of, 41
Commodity, 364–365
Commodity Futures Trading Commission (CFTC), 399
Common stock, 364
Communication skills
bad news message as, 351
delivering good news messages as, 327
formal speaking as, 261
informal speaking as, 225
listening as, 8, 53, 96
persuasive message as, 402
persuasive speaking as, 294
reading as, 121, 156, 190
Community banks, 181
Community colleges, 14–15
Company reports, 378
Comparison shopping, 98, 211, 223–224, 270
Complaint, 302
Compound interest, 164
Comprehension, reading, 156
Comprehensive coverage, 209
Computer software, money management, 131
Computing interest, 163–164
Conflict, dealing with, 131
Consideration, 252
Consumer Action Handbook, 283
Consumer advocacy groups, 282–283
Consumer Bill of Rights, 101
Consumer complaint program, 178
Consumer finance company, 270
Consumer Financial Protection Bureau, 284, 402
Consumer loan, 230
Consumer Price Index (CPI), 78, 350
Consumer Price Index for Urban Dwellers (CPI-U), 83
Consumer Product Safety Commission (CPSC), 104
Consumer protection
laws for, 102–104, 178
sources of, 104–105
Consumer Reports, 105, 110, 378
Consumer rights, 101
laws for, 101–102
Consumer Technology Bill of Rights, 102
Consumers
buying strategies of, 88–90, 97–98
credit rights, 298–301
dispute resolution methods for, 302–303
education, 177
financial reform laws for, 401–403
fraud, types of, 106–108
protection from fraud, 108–110
protection services for, 178, 283–284
responsibilities of banking, 176–178
rights of, 177–178
Consumers Union (CU), 105
Contact, defined, 21
Contingencies, 315
Contract, 252
Conventional loan, 260
Convertible bond, 349
Cookies, on Internet, 95
Cooperative work experience, 22
Copays, 195, 197
Corporate bonds, 348–349
Cost, opportunity, 121
Cost-of-living adjustments (COLA), 78
Cost-plus pricing, 87
Cost-push inflation, 81–82
Cost-recovery pricing, 86–87
Coupon rate, 348
Cover letter, 28
CPI. *See* Consumer Price Index (CPI)
CPI-U. *See* Consumer Price Index for Urban Dwellers (CPI-U)
CPSC. *See* Consumer Product Safety Commission (CPSC)
Creative listening, 96
Credit
application for, 228
benefits of, 232–233
career in, 245
charge cards, 229
choices, 241–242
consumer loan, 230
costs of, 236–242, 270–272, 299–300
credit cards, 229. *See also* Credit card
explanation of, 228
installment, 229
line of, 230–231
management, 267–269
online, 241
penalties for, 240
policies, 239–240
recourse for denial of, 298
revolving, 229
scams, 304–305
score, 233
service, 228
store accounts, 229
unused, 267
Credit bureau, 231
Credit Card Act of 2009, 300
Credit card fraud, 282
steps to prevent, 282
Credit cards
billing cycle, 267
explanation of, 229
fraud. *See* Credit card fraud
interest rates for, 236–239
keeping records of use of, 232–233
practices, 300
statements, 242
wise use of, 270
Credit counseling, 291
Credit delinquency, 285
Credit limit, 240
lowering, 240
Creditor, 228
Credit problems
consumer advocacy groups to assist with, 282–283
delinquency as, 285
disputing charges for, 280–281
fraud as, 282
government consumer protection services to assist with, 283–284
Credit protection service, 299
Credit repair, 304
Credit reports, 231, 298–299
Credit scoring system, 233
Credit unions, 159
Criteria, 222
Critical listening, 53
CU. *See* Consumers Union (CU)
Customer loyalty program, 96
Customer service
to promote sales, 93–94

D

Data miners, 287
Day traders, 365

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Debit cards, 151, 153
Debt collections, 285–286
Debt consolidation, 292
Debt load
  management, 269
Debt management, 291–292
Debt problems
  actions to resolve, 285
  warning signs of, 284
Debt repayment plan, 262
Debtor, 228
Deception, defined, 106
Deceptive practices, identifying, 108
Decision-making process, 121–122
Decreasing term insurance, 200
Deductibles, 194, 197, 210
Deductions
  optional, 64
  paycheck, 61–64
  required, 61–64
Defendant, 302
Deferred-payment loan, 262
Defined-benefit plans, 360
Defined-contribution plans, 359–360
Deflation, 80
Delinquency, credit, 285
Demand
  creation of, 94–96
  explanation of, 11, 12
  strategies to meet, 93–94
Demand deposit account, 149. *See also* Checking accounts
Demand-pull inflation, 81
Dental plans, 196
Department of Labor, U.S., 3, 39, 40
Department of the Treasury, 400
Dependent, defined, 61
Deposits
  to checking or savings accounts, 150–151, 153–155
  direct, 155
  in transit, 157
Depreciation
  of assets, 120, 368
  car, 258
Difficult people, 303
Direct benefits, of paying taxes, 58
Direct deposit, 155
Direct investing, 363–365, 385
Direct taxes, defined, 55
Disability insurance, 47, 198–199
  long-term, 199
  short-term, 198–199
Discharge, 292
Disclosure terms, 268–269
Discount, 167, 212
  multiline, 211
Discount bond, 347
Discount broker, 381–382, 393
Discount pricing, defined, 94
Discount rate, defined, 81
Discretionary income, 119
Discretionary order, 390
Disinflation, 79
Disposable income, 45
  defined, 61
Dispute letter, 281
Dispute resolution, 302–303
Disputing a charge, 280
Diversification, 333
Dividend, 324
  defined, 51
Doctorate degree, 16
Documentation, 280
Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, 402–403
Dollar-cost averaging, 333, 334
Down payment, 258
Drawee, 152
Drawer, 152

E

Early withdrawal penalty, 345–346
Earned income, 51–52
  explanation of, 39
  salaries as, 40
  from self-employment, 42–44
  sources of, 39–41
  tips and commissions as, 40, 41
  wages as, 39
Earnings. *See also* Wages
  education level and, 14
Easy access credit, 241
Economic decline, 12–13, 336
Economic growth, 336
Economist, 11
Economy
  in action, 12–13
  buying optimism related to, 268
  defined, 11
  income affected by, 11–12
  investments and, 336
  prices affected by, 11
Edmunds.com, 98
Education
  benefits for, 46
  career in, 113
  consumer, 177
  costs of, 13–16
  earnings, difference in, 7
  and income, 7–8
  methods to pay for, 16–18, 316
  public *vs.* private, 14–15
E-filing, 69
EFT. *See* Electronic funds transfer (EFT)
Elective surgery, 196
Electronic ads, 95
Electronic funds transfer (EFT), 155
Electronic records, 131
Emergency fund, 313
Emergency Homeowners' Relief Fund, 403
Emergency plan, 64
Emotional buying, defined, 88
Employee benefits, 45–48
  educational benefits as, 46
  explanation of, 45
  health spending accounts as, 48
  insurance as, 47
  optional deductions, 48
  pay without work as, 45–46
  perks as, 46
  profit-sharing plans as, 47–48
  retirement plans as, 47, 359–360
  stock option plans as, 48
Employer-sponsored plans, 328
Employment
  during college/training programs, 18
  self-, 42–44
Employment agencies, 24
Employment application. *See* Job application
Employment Eligibility Verification Form, 63
Encryption, 131
Endorsements, 153–154
  blank, 154
  check, 154–155
  in full, 154
  restrictive, 154
  special, 154
Entitlement programs, defined, 53
Entrepreneurs, 42–44
Equal Credit Opportunity Act, 300, 301
Equifax, 231
Equity, 260
  loan, 292
  stripping, 271
Estate, 319
Estate planning, 319–320
Estate tax, 57
Ethical issues
  explanation of, 18
  honesty in applying for aid, 18
  loan practices as, 271–272
Eviction, 254
Excel®, 150
Excise taxes, 55
Executor, 320
Exemption, 293
  defined, 61
Expenses
  charitable giving, 128
  estimation of, 125, 128
  fixed, 128
  variable, 128
Experian, 231
Extended warranty, 224

F

FAA. *See* Federal Aviation Administration (FAA)
Face value, 167, 200, 347
FAFSA. *See* Free Application for Federal Student Aid (FAFSA)
Fair Credit Billing Act, 300, 301
Fair Credit Reporting Act, 298
Fair Debt Collection Practices Act, 301
Fair Isaac Corporation (FICO), 233
  scores, 233
Fake sales, 106
Families, saving to provide for, 317
Family Educational Rights and Privacy Act (FERPA), of 1974, 103
Favorable variance, 129
FBI. *See* Federal Bureau of Investigation (FBI)
FBLA. *See* Future Business Leaders of America (FBLA)
FCC. *See* Federal Communications Commission (FCC)
FDA. *See* Food and Drug Administration (FDA)
FDIC. *See* Federal Deposit Insurance Corporation (FDIC)
FEA. *See* Future Educators Association (FEA)
Fed. *See* Federal Reserve System (Fed)
Federal agencies, for consumer protection, 104
Federal Aviation Administration (FAA), 104
Federal Bureau of Investigation (FBI), 284
Federal Communications Commission (FCC), 104
Federal consumer protection agencies, 283–284
Federal Deposit Insurance Corporation (FDIC), 397–398
  explanation of, 149–150, 163
  takeovers, 403
Federal funds rate, defined, 81
Federal Housing Administration (FHA) loan, 260
Federal Insurance Contribution Act, 63
Federal Reserve System (Fed), 81, 177, 401
Federal Student Aid Office, 16
Federal Trade Commission (FTC), 104, 283
  identity theft information from, 140
Fee-for-service plans, 194
Fees, defined, 13
FERPA. *See* Family Educational Rights and Privacy Act (FERPA)
FHA loan. *See* Federal Housing Administration (FHA) loan
FICA tax, 63
FICO. *See* Fair Isaac Corporation (FICO)
Finance charges, 236
Financial advisers. *See* Financial planners
Financial advising services, of banks, 174
Financial aid, 16
  ethical issues, applying for, 18
Financial expert, 138–139
Financial Fraud Enforcement Task Force, 284

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Financial goals, 136
Financial Industry Regulatory Authority (FINRA), 383, 398
Financial institutions, 383
Financial irresponsibility, 221
  effect of, 221
  characteristics of, 221
Financial judgment, 188
Financial Literacy and Education Commission, 400
Financial loss, risk of, 187
Financial markets, 335, 384
Financial plan, 134. *See also* Money management
  analyzing information for, 135–136
  developing a timetable and benchmarks for, 136–137
  explanation of, 134
  gathering information for, 134–135
  implementing and evaluating, 137
  setting goals for, 136
Financial planners, 138, 382–383, 383
Financial records, 134
Financial reform laws, 401–403
  Sarbanes-Oxley, 401
  Wall Street Reform Act, 402–403
Financial resources
  explanation of, 118–119
  protection, 140
  risk of, 188
Financial responsibility, 220–221
  systematic decision making and, 220
Financial responsibility laws, 208
Financial sections/articles, 139
Financial security, 317
  savings and, 313–314
Financial websites, 139
Financing options, 224
FINRA. *See* Financial Industry Regulatory Authority (FINRA)
Firewall, 140
Fiscal policy, for managing inflation, 81
Fixed expenses, 128
Fixed interest rate, 236
  vs. variable interest rate, 236–237
Fixed-rate mortgage, 260
Flex 125 plan, 48
flexible spending account (FSA), 48, 197
Floating a check, 177
Follow-up, after interview, 31
Food, Drug, and Cosmetic Act of 1938, 102
Food and Drug Administration (FDA), 104
Forbes, 377
Foreclosure, 286, 287
Forgery, 153
Form 1040A, 68–69
Form 1040EZ, 65, 66–68
Form I-9, 63
Form 1099-INT, 68
Form W-2, 65, 66
Form W-4, 61, 62
Formal education, defined, 7
Formal speaking, 261
Fortune, 377
Foundation, 319–320
401(k) plan, 359
401(k) retirement plans, 47
403(b) plan, 359–360
Franchise, 366–367
Frauds
  bankruptcy, 295
  credit card, 282
  health and medical product, 107–108
  information of, 110
  protection from, 108–110
  telemarketing, 287
  types of, 106–108
  warning signs of, 108
Fraudulent representation, 107
Free Application for Federal Student Aid (FAFSA), 16
FSA. *See* flexible spending account (FSA)
FTC. *See* Federal Trade Commission (FTC)
Full scholarship, 17
Full-service broker, 381, 382
Future Business Leaders of America (FBLA), 15
Future Educators Association (FEA), 15
Future value of money, 164–166
Futures contracts, 364–365

G

Gambling
  vs. investment risk, 326
Game of chance, 326
Garnishment, 286
Gasoline tax, 55
Gems, as investments, 369
Gift tax, 57
Global banks, 181
Goals
  benchmarks, 137
  defined, 6
  financial, 136, 317–318
  long-term, 136, 316–317
  medium-term, 136, 315–316
  personal, 136, 315–317, 318
  short-term, 136, 315
  timeline, 136–137
Good news messages, 327
Google, 379
Government bonds
  and securities, 349–350
Government transfer payments, 52–54
Grace period, 268
Grants, 16
Gratification, delayed, 136
Gross pay, defined, 61
Gross profit. *See* Profit margin
Group budgeting, 251, 252
Group life insurance, 47, 201–202

H

Hackers, 140
Hard-copy format, recordkeeping and, 130
Hard skills, defined, 2
Hazardous Substances Act of 1960, 103
Headhunter, 24
Health care
  government-sponsored, 195
  managing costs of, 197
  role in, 195
  types of coverage for, 195–196
Health care directive, 320
Health care fraud, 202
Health care reform law, 198
Health insurance, 47
Health insurance plans
  coverage of, 195–196
  explanation of, 194
  types of, 194–195
Health Insurance Portability and Accountability Act (HIPAA), of 1996, 104
Health maintenance organization (HMO), 195
Health savings account (HSA), 48, 197
Heirs, 320
High-risk pools, 212
HIPAA. *See* Health Insurance Portability and Accountability Act (HIPAA)
HMO. *See* Health maintenance organization (HMO)
Holidays, paid, 45
Holographic will, 320
Home inventory, 206–207
Homeowner's insurance
  coverage of, 205–206
  explanation of, 205
Honesty, in applying for aid, 18
House ownership, 317, 318
Houses, as investments, 356
HSA. *See* Health savings account (HSA)
HUD. *See* U.S. Department of Housing and Urban Development (HUD)
Hurricane Katrina, 54
Hyperinflation, 79–80

I

Identity theft, 140, 153, 304–305
Illiquid investments, 344
Impulse buying, defined, 88–89
Inactive account, 176
In-cash transfer payments, 54
Income
  choices affecting, 1
  discretionary, 119
  disposable, 45
  earned, 39–41, 51–52
  economic conditions affecting, 11–12
  education and, 7–8, 13–18
  estimated, 125
  government transfer payments as, 52–54
  job choices affecting, 4–6
  job market and, 2
  measurement, 119–120
  method for estimating, 127
  from pay without work, 45–46
  sources of, 38, 42–44
  types of, 51–52
  unearned, 51–54
  variable, 51
  variances in, 129–130
Income tax
  electronically filing, 69
  explanation of, 56, 61, 62
  forms for filing, 65–69
Indirect benefits, of paying taxes, 58
Indirect investing, 354–355
Indirect taxes, defined, 55
Individual debt adjustment, 294
Individual retirement accounts (IRA), 168, 327, 357–358
  roth, 358
  spousal, 358
  traditional, 358
Individual retirement arrangement, 168
Industry risk, 325
Inflation
  causes of, 80–83
  cost-push, 81–82
  by CPI-U, 83
  demand-pull, 81
  effects of, 76, 81, 82–83
  on employment, 82
  explanation of, 77
  measurement of, 78
  policies to manage, 81
  real-cost, 82
  on spending, saving, and investing, 82–83
  types of, 79–80
  vs. purchasing power, 78
Inflation/employment tradeoff, defined, 82
Inflation risk, 325, 345
Infomercials, frauds and, 108
Informal education, defined, 7
Informal speaking, 225
Information technology (IT)
  careers in, 372
Inheritance tax. *See* Estate tax
Initial public offering (IPO), 366, 384
In-kind transfer payments, 54
Installment credit, 229
Installment loan, 258
Instant credit offer, 241
Insurance, 47

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

automobile, 208–209
career in, 215
costs of, 210–212
deductions for, 64
disability, 47, 198–199
health, 47, 48
homeowner's, 205–207
life, 47, 199–202
maximizing benefits of, 212
renter's, 207
review coverage, 212
as transfer of risk, 189
types of, 47–48
umbrella, 212
using Internet to buy, 211
workers' compensation, 47, 63–64
Insurance agency, 211
Interchange fees, 403
Interest
explanation of, 16–17
methods of computing, 237–239
for saving account, 163–164
unearned income and, 51
Interest rates, 268
for credit cards, 236–239
fixed, 236
for mortgages, 263
role of Fed in controlling, 81
variable, 236–237
Internal Revenue Service (IRS), 51, 61, 400–401
International banks, 169
Internet
advertising on, 95
articles, 139
banking on, 174
buying insurance on, 211
credit approval on, 241
financial websites, 139
and identity theft, 305
investment research on, 379
job openings in, 21, 22, 23
product research on, 223–224
scam, 140
Introductory rate, 241
Investing, 313
Investment adviser, 138
Investment club, 365
Investment-grade bonds, 349
Investment portfolio, 333
Investment risk, 325
reduction, 333–335
return and, 323
vs. gambling, 326
Investment tracking, 332
Investments. *See also* Savings; specific types of investments
agencies regulating, 397–401
in business ownership, 366–367
cash for, 391
collectibles as, 369
direct, 363–365, 385
diversification for, 333
economy and, 336
gems as, 369
high-risk options for, 363–369
ideal, features of, 323
illiquid, 344
indirect, 356
long-term focus of, 331–332
for long-term goals, 316–317
low-risk options for, 347–351
medium-risk options for, 354–356
for medium-term goals, 315–316
precious metals as, 369
principles of, 323–324
purpose of, 313–320
real estate as, 356, 367–369
return on, 324
risks of, 325–326
for short-term goals, 315
sources of information on, 377–380
strategies for, 331–336
systematic, 331
tax advantages of, 327–328
using spreadsheets to track, 357
wealth and, 313, 314
Investor newsletters, 378
Involuntary bankruptcy, 290
IPO. *See* Initial public offering (IPO)
IRA. *See* Individual retirement accounts (IRA)
IRS. *See* Internal Revenue Service (IRS)
IT. *See* Information technology (IT)

J

Job agent. *See* Job scouts
Job application, 29, 30
Job description, 5
Job interview, preparing for, 29, 31
Job market, defined, 2
Job openings
cooperative work experience in, 23
employment agencies for, 24
job scouts, 23–24
placement centers for, 23
from school counselors, 23
seeking, 21–23
social networking sites in, 21, 22
state employment offices for, 24
from teachers, 23
temp agencies for, 24
ways to find out, 21–24
websites for, 23
Job requirements, 5
Job scouts, 23–24
Job shadowing, 22
Job title, 5
Joint account, 150
Journalism careers, 34
Judgment, 285
financial, 188

K

Kefauver-Harris Drug Amendment of 1962, 103
Keogh account, 358–359

L

Land, investments in, 367–368
Landlords
rights and responsibilities, 254–255
Late fees, 269
Law enforcement careers, 275
Lawsuits, 302–303
class action, 303
Learning, lifelong, 5–6
Lease, 252, 253, 255, 263–264
Leisure time, 315
Lessee, 255. *See also* Tenants
Lessor, 255. *See also* Landlords
Level term insurance, 200
Liability, 119
coverage, 206, 208
personal, 206
Liar loans, 403
Life insurance
explanation of, 47, 199
group, 201–202
permanent, 200–201
savings plans, 346
term, 200
Lifelong learning, 5–6
Lifestyle business, 42
Limit order, 390
Limited-pay life insurance, 201
Line of credit, 230–231
Liquid, 323
Liquidation, meaning of, 109
Liquidation bankruptcy. *See* Chapter 7 bankruptcy
Liquidity, 314
Listening. *See also* Communication skills
creative, 96
critical, 53
importance of, 8
Living arrangement, 250–251
Living habits, 250
Living will, 320
Loan forgiveness, 262
Loan modification, 285
Loan shark, 271
Loans, 16–17
advance-fee, 271
bank, 174
car, 258
consumer, 230
conventional, 260
debt consolidation, 292
FHA, 260
forgiveness, 262
installment, 258
liar, 403
preapproved, 258
private student, 17
from sales finance companies, 270
secured, 286
student. *See* Student loans
subsidized student, 17
unethical practices related to, 271–272
upside-down, 258
Logistics, 251
Long-term care insurance, 196
Long-term debt, 258–261
Long-term disability insurance, 199
Long-term goals, 136
Loss, 186
Low-balling, 106
Luxury items, 118
Luxury tax, 55

M

MACAP. *See* Major Appliance Consumer Action Panel (MACAP)
Magazines
advertising in, 94
investment information in, 377–378
Major Appliance Consumer Action Panel (MACAP), 105
Managed care plan, 194
Manual records, 130–131
Manufacturing career, 143
Margin, 392
Margin call, 392
Market, 335
Market-based pricing, 87–88
Market economy
defined, 11
explanation of, 86
setting prices in, 86–88
Market order, 390
Market timing, 332–333
Market value, 259
Marketing careers, 339
Marketing mix, 88
Markup, defined, 87
MasterCard, 175
Master's degree, 16
Maturity date, 347
Maturity value, 167
Means test, 293
Mediation, 302
Medicaid, 53, 54, 195

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Medical coverage, 196
Medicare, 54, 195
  tax, 63
Medium-term goals, 136, 315–316
Membership fee, 268
Microsoft Excel, 125, 131, 357
Minimum finance charge, 268
Minimum payments, 239–240
Minimum wages, defined, 39
Monetary policy, for managing inflation, 81
Money, 378
  time value of, 83
Money management. *See also* Banks; Financial plan
  analyzing your financial resources for, 118–119
  budgeting as, 125–130
  buying decisions and, 121–122
  computer software for, 131
  financial advice for, 138–140
  financial planning as, 134–139
  financial resources protection as, 140
  income and wealth measurement, 119–120
  recordkeeping for, 130–131
Money market accounts, 167, 345
Money market fund, 345
Money match, 328
Money order, 173
Month-to-month agreement, 255
Monthly account fees, 175
Moody's Investors Service, 378
Mortgage, 232, 260
  adjustable-rate, 260
  debt, 263
  fixed-rate, 260
Multiline discounts, 211
Municipal bonds, 351
Mutual funds, 334, 354–356
  asset allocation in, 356
  types, 355
MyMoney.gov, 400

N

NASDAQ stock market, 384–385
National Consumers League (NCL), 105
National Credit Union Administration (NCUA), 398
National Credit Union Share Insurance Fund (NCUSIF), 398
National FFA, 15
National Foundation for Credit Counseling, 292
National Traffic and Motor Vehicle Safety Act of 1966, 103
Natural disaster
  government transfer payments for, 52–54
Naturopathic choices, 195
NCL. *See* National Consumers League (NCL)
NCUA. *See* National Credit Union Administration (NCUA)
NCUSIF. *See* National Credit Union Share Insurance Fund (NCUSIF)
Needs, 118
Negotiation, 178, 302
Net income, 119
Net loss, 119
Net pay, defined, 61
Net worth, 119
New York Stock Exchange (NYSE), 364, 384
Newspapers
  advertising in, 94
  investment information in, 378
Newsweek, 377
No-fault insurance laws, 209
Nonsufficient funds (NSF), 173, 175
Nonsystemic risk, 187
Normal profit, defined, 86
NSF. *See* Nonsufficient funds (NSF)
Nutrition Labeling and Education Act of 1990, 103
NYSE. *See* New York Stock Exchange (NYSE)

O

OCC. *See* Office of the Comptroller of the Currency (OCC)
Occupational Outlook Handbook (OOH), 3
Occupations
  fastest-growing, 4
Odd lot, 393
Office of the Comptroller of the Currency (OCC), 399–400
Office of Thrift Supervision (OTS), 399
Off-site manager, 254
Online brokers, 382
Online credit, 241
Online-only banks, 169. *See also* Banks
Online shopping, 95, 98
On-site manager, 254
On-the-job training, 7
OOH. *See* Occupational Outlook Handbook (OOH)
Opportunity cost, 121, 222
OTC market. *See* Over-the-counter (OTC) market
Other needs, 118
OTS. *See* Office of Thrift Supervision (OTS)
Outstanding checks, 158
Overdraft protection, 173
Oversight, 397
Over-the-counter (OTC) market, 384–385
Over-the-limit fees, 240, 269
Overtime pay, defined, 39

P

PA. *See* Physician assistants (PA)
Paid holidays, 45
Par value, 386
Partial scholarship, 17
Partnership, 366
Patients' Bill of Rights, 102
Pay to the order of, 154
Pay without work, 45–46
Pay-yourself-first strategy, 315
Paycheck deductions, 61–64
Payday loan, 241, 242
Payee, 152
Payments
  methods for, 224
  transfer, 52–54
PBGC. *See* Pension Benefit Guaranty Corporation (PBGC)
Peak period, in business cycle, 12
Pell Grants, 16
Penalties
  explanation of, 240
Pension Benefit Guaranty Corporation (PBGC), 398–399
Pension plans, 47, 360
Perks, defined, 46
Permanent life insurance, 200–201
  limited-pay, 201
  universal, 201
  variable, 201
  whole life, 200–201
Personal cash flow statement, 119, 120
Personal goals, 136
Personal identification number (PIN), 153
Personal injury protection (PIP), 209
Personal leave, defined, 46
Personal liability, 206
Personal net worth statement, 119–120
Personal property, 205
Personal risk, 187
Persuasive message, 402
Persuasive speaking, 294
Phi Beta Lambda, 15
Philanthropists, 129
Philanthropy, 129
Phisher, 140
Phishing, 140, 305
Physician assistants (PA), 5
Pigeon drop, 107
Piggybacking, 211–212
PIN. *See* Personal identification number (PIN)
PIP. *See* Personal injury protection (PIP)
Placement centers
  role in job openings, 23
Plaintiff, 302
Point-of-sale (POS) terminal, 153
Political risk, 325–326
Ponzi scheme, 107
Pop-up ads, on Internet, 95
Portability, retirement plan, 360
Portable insurance, 202
Postdated check, 152
POS terminal. *See* Point-of-sale (POS) terminal
PPO. *See* Preferred provider organization (PPO)
Preapproved loan, 258
Precious metals, as investments, 369
Preferred provider organization (PPO), 194–195
Preferred stock, 364
Premium, 190
  defined, 47
  strategies for cost reduction, 210–212
  timing of, 211
Premium bond, 348
Prepayment penalty, 264
Previous balance method, 238
Prices
  economic conditions that affect, 11
Pricing
  cost-plus, 87
  cost-recovery, 86–87
  discount, 94
  market-based, 87–88
  for sales promotion, 94
  value-based, 87
Primary market, 384
Prime rate, defined, 81
Principal
  explanation of, 163
  growth of, 324
Private education, cost of, 14–15
Private organizations, for consumer protection, 105
Probability, 186
Probate, 320
Product
  for sales promotion, 94
Product differentiation, defined, 87
Productivity, defined, 82
Profit, defined, 42
Profit margin, defined, 87
Profit-sharing plans, 47–48
Progressive tax, defined, 56
Property manager, 254
Property taxes, 56–57
Proprietorship, 366
Prospectus, 378–379
Public Company Accounting Oversight Board, 401
Public Company Accounting Reform and Investor Protection Act of 2002, 401
Public education, cost of, 14–15
Public goods, defined, 58
Public officials, for consumer protection, 105
Purchase, 224. *See also* Buying Plan
  evaluation of, 225
Purchasing power, inflation *vs.,* 78
Pure insurance, 200
Pyramid scheme, 106

Q

Quicken®, 131, 150

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s). Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

R

Radio advertising, 94–95
Rational buying, defined, 88
Reading, as communications skill, 121, 156, 190
Reading speed, 190
Real-cost inflation, 82
Real estate, as investments, 356, 367–369
Real estate investment trust (REIT), 368
Real property, 205
Rebates
  credit card companies offering, 271
  explanation of, 223
Recession, defined, 12–13
Recordkeeping, 130–131
  electronic, 131
  importance of, 130
  manual, 130–131
Recovery period, in business cycle, 12
Redress, seeking, 110
Reference letter, 27
References, 27
Refinancing, 259
Reflation, 79
Regional banks, 181
Regressive taxes. *See* Sales taxes
Regulatory agencies, 397–401
  CFTC, 399
  FDIC, 397–398
  Fed, 401
  FINRA, 398
  IRS, 400–401
  NCUA, 398
  OCC, 399–400
  OTS, 399
  PBGC, 398–399
  SEC, 400
REIT. *See* Real estate investment trust (REIT)
Relationship banking, 175
Renewable term insurance, 200
Rent-to-own agreement, 263–264
Rental property, 368
Renter's insurance, 207
Reorganization, 293
Replacement cost, 207
Reports, credit, 231
Repossession, 286, 287
Research
  Internet, 379
  product, 223–224
Reserves, defined, 81
Residency, 16
Resources, financial, 118–119
Responsible shopping, 220–221
Restrictive endorsement, 154
Resumes, 25
  guidelines for, 26
  scannable, 26–27
Retirement planning, 318–319
Retirement plans, 47
  defined-benefit, 360
  defined-contribution, 359–360
  medium-risk options for, 357–359
  portability of, 360
Retraining, 12
Return, 324
  investment risk and, 323
  maximizing, 335–336
Return on investment (ROI), 324
  calculation of, 324
Revolving credit, 229
Rewards features, 232
Rider, 207
Right of first refusal, 263
Risk
  assessment, 188, 189
  assuming, 190–191
  avoidance, 189
  explanation of, 186–187
  of financial loss, 187
  of financial resources, 188
  industry, 325
  inflation, 325
  investment, 325
  personal, 187
  political, 325–326
  reduction, 188
  retention, 191
  stock, 326
  transferring, 189–190
Risk-free investments, 323
ROI. *See* Return on investment (ROI)
Rollover, 360
Roommate, 250
Roth IRA, 358
Round lot, 393
Royalties, defined, 51
Rule of 72, 166

S

Safe deposit boxes, 172
SafeAuto Insurance Company, 208
Safety, workplace, 64
Safety of principal, 313
Salaries. *See also* Earnings; Wages
  explanation of, 40
Sales
  direct, 95
  online, 95, 98
Sales finance company, 270
Sales taxes, 55–56
Sarbanes-Oxley (SOX), 401
Savings, 313. *See also* Investments
  diversification for, 333
  financial security and, 313–314
  life insurance plans, 346
  liquid form of, 344
  for long-term goals, 316–317, 331–332
  low-risk options for, 344–347
  for medium-term goals, 315–316
  options for, 166–169
  places for, 169
  plan, 127–128
  principles of, 323–324
  purpose of, 313–320
  return on, 324
  risks of, 325–326
  for short-term goals, 315
  strategies for, 331–336
  systematic, 331
  tax advantages of, 327–328
  variances in, 129–130
Savings accounts
  computing interest for, 163–164
  deposit to, 150–151, 153–155
  explanation of, 162, 344–345
  future value of money for, 164–166
Savings bonds
  I, 350
  series EE, 350
  U.S., 323, 334
SBA. *See* Small Business Administration (SBA)
SBDC. *See* Small Business Development Center (SBDC)
Scams
  affecting consumers, 304–305
  credit repair, 304
  explanation of, 304
  Internet, 140
Scannable resumes, 26–27
Scarcity, economics and, 11
Scholarships, 17
School counselors
  role in job openings, 23
SEC. *See* Securities and Exchange Commission (SEC)
Secondary market, 384
Secured loan, 286
Securities, 378
  buying and selling, 389–394
  government bonds and, 349–350
  primary market for, 384
  secondary market for, 384
  state and local, 351
Securities and Exchange Commission (SEC), 104, 363, 400
Securities exchange, 384
Security deposit, 251
Security question, 150
Self-employment, 42–44
  income, 39
Self-insure, 191
Self-training, 7
Selling short, 391
Selling strategies, 93–96
Seminars, 139
SEP accounts. *See* Simplified employee pension (SEP) accounts
Service credit, 228
Shared responsibility, 250–251
  explanation of, 250
Shipping costs, 98
Shopping
  comparison, 98, 211, 223–224, 270
  online, 95, 98
  smart, 109
Short-term disability insurance, 198–199
Short-term goals, 136, 315
Sick leave, defined, 46
Signature card, 150
Signs, for advertising, 95
Silent partners, 367
Simple interest method, 164
Simple will, 320
Simplified employee pension (SEP) accounts, 358
Skill set, defined, 2
Skimming, 305
Small Business Administration (SBA), 261
Small Business Administration (SBA) website, 43
Small Business Development Center (SBDC), 43
Small claims court, 302
Smart card, 174
SmartMoney, 378
SMDIA. *See* Standard maximum deposit insurance amount (SMDIA)
Social network, 21
Social networking sites, 21, 22
Social Security Act, 199
Social Security benefits, 54
Social security tax, 62, 63
Soft-copy format, recordkeeping and, 131
Soft skills, 2
SOX. *See* Sarbanes-Oxley (SOX)
Space-shifting, right for, 102
Spam, 305
Speaking. *See also* Communication skills
  informal, 225
  persuasive, 294
Special endorsement, 154
Speculative-grade bonds, 349
Speculative investments, 334
Spending limit, 223
Spending power
  credit and, 232
Spousal IRA, 358
Spreadsheet software, 125
Spreadsheets, tracking investment on, 357
Standard maximum deposit insurance amount (SMDIA), 163
Standard & Poor's Corporation, 349
Standard & Poor's Stock Reports, 378
State and local assistance, for consumer protection, 105
State consumer protection agencies, 284
State employment offices, 24

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.

Stock dividends, 385, 386
defined, 51
Stock option plans, defined, 48
Stock risk, 326
Stock split, 386
Stock turning, 393
Stockbrokers, 364, 381–382
Stockholders, 363
Stocks, 363–364
buying and selling, 389–394
buyout timing, 394
common, 364
cost management of, 393–394
explanation of, 326
preferred, 364
transactions for, 389–390
Stop-loss provision, 197
Stop order, 390
Stop payment, 173, 176
Store account, 229
Store location, convenient
for sales promotion, 93
Stored value card, 174–175
Straight bankruptcy. *See* Chapter 7 bankruptcy
Straight life/ordinary life insurance. *See* Whole life insurance
Stress management, 272
Student loans, 17
debt, 262
subsidized, 262
unsubsidized, 262
Student organizations, 15
Study reading, 156
Subsidized student loans, 17, 262
Substitute checks, 158
Supply, defined, 11
Systematic decision making, 220
financial responsibility and, 220
Systematic investing, 331
Systematic saving, 331
Systemic risk, 186

T

Take-home pay. *See* Net pay
Target audience, 94–96
defined, 94
Tax collection, career in, 72
Tax deferral, 327
Taxes
benefits of paying, 57–58
on consumption, 55–56
direct, 55
excise, 55
explanation of, 39
gasoline, 55
income, 56, 61, 62, 65–69
indirect, 55
Medicare, 63
property, 56–57
sales, 55–56
on savings and investments, 327–328
types of, 55–57
on unearned income, 52
use, 55
on wealth, 56–57
Tax-exempt, 327–328
Tax-free investments, 327–328
Tax shelter, 349
T-bills. *See* Treasury bills (T-bills)
Teachers
role in job openings, 23
Teams, skills for working in, 41
Technical schools, 15
Telemarketing, 96
fraud, 287
Television advertising, 94–95
Temp agencies, 24
Tenants, 207
rights and responsibilities, 252, 254
Term life insurance, 200
Thank-you letter, 31
Third-party checks, 155
Time, 377
Time management, 90
Time share, 365
Time-shifting, right for, 102
Time value of money, 83
Timeline, 136–137, 223
TIPS. *See* Treasury Inflation-Protected Securities (TIPS)
Tips, 40, 41
T-notes. *See* Treasury notes (T-notes)
Towing/rental car coverage, 209
Trade-in, 258
Tradeoff, 121
Traditional IRA, 358
Training
cost of, 15–16
employee reimbursements for, 46
ways to pay for, 16–18
Transaction fees, 159, 269
Transfer payments
government, 52–54
in-cash, 54
in-kind, 54
Transit advertising, 96
Transposition errors, 158
TransUnion, 231
Traveler's check, 173
Treasury bills (T-bills), 350
U.S., 323
Treasury bonds, 350
Treasury Inflation-Protected Securities (TIPS), 350
Treasury notes (T-notes), 350
Treasury Secretary, 403
Trends, stock price, 332
Trough, defined, 13
Truncated checks, 158–159
Trust will, 320
Truth-in-Lending Act, 299–300
Tuition, 13, 14, 15

U

Umbrella policy, 212
Unearned income
government transfer payments as, 52–54
private sources of, 51–52
Unfavorable variance, 129
Uninsured/underinsured motorist coverage, 209
Unit pricing, defined, 109
Universal life insurance, 201
Unmanaged care plan, 194
Unsubsidized student loans, 262
Unused credit, 267
Upside-down loan, 258
U.S. Department of Agriculture (USDA), 104
U.S. Department of Housing and Urban Development (HUD), 403
U.S. Department of Justice, 284
U.S. News & World Report, 377
U.S. savings bonds, 167–168, 323, 334
U.S. Treasury bills, 323
USA Jobs, 23
USDA. *See* U.S. Department of Agriculture (USDA)
Use taxes, defined, 55
Usury laws, 271

V

Vacant lot, investments in, 367–368
Vacation planning, 315
Value-based pricing, 87
Value Line Investment Survey, 378
Values, defined, 6
Variable expenses, 128
Variable income, 51–52
Variable interest rate, 236–237
vs. fixed interest rate, 236
Variable life insurance, 201
Variances, 129–130
Vehicle ownership, 316, 318
Venture business, 42–43
Verdict, 303
Vested, 328
Visa, 175
Vision coverage, 196
Vita, 25
Vocabulary, 121
Voluntary bankruptcy, 290

W

Wages, 39. *See also* Earnings; Income; Salaries
Wall Street Journal, 378
Wall Street Reform Act, 402–403
Wants, 118
Warning labels, 103
Warranty, 224
defined, 109
extended, 224
Wealth, 313
investments and, 313, 314
measurement, 119–120
Websites
AnnualCreditReport.com, 298
Edmunds.com, 98
financial, 139
for job openings, 23
MyMoney.gov, 400
retail, 98
Wedding planning, 316
Whole life insurance, 200–201
Will
explanation of, 320
holographic, 320
living, 320
simple, 320
trust, 320
Will kit, 320
Withdrawal, 151
automatic, 151–152
Workers' compensation, 47, 63–64
Workplace safety, 64
Workshops, 139
Work-study programs, 17–18

Y

Yahoo, 379

Z

Zero coupon bond, 349

Copyright 2010 Cengage Learning. All Rights Reserved. May not be copied, scanned, or duplicated, in whole or in part. Due to electronic rights, some third party content may be suppressed from the eBook and/or eChapter(s).
Editorial review has deemed that any suppressed content does not materially affect the overall learning experience. Cengage Learning reserves the right to remove additional content at any time if subsequent rights restrictions require it.